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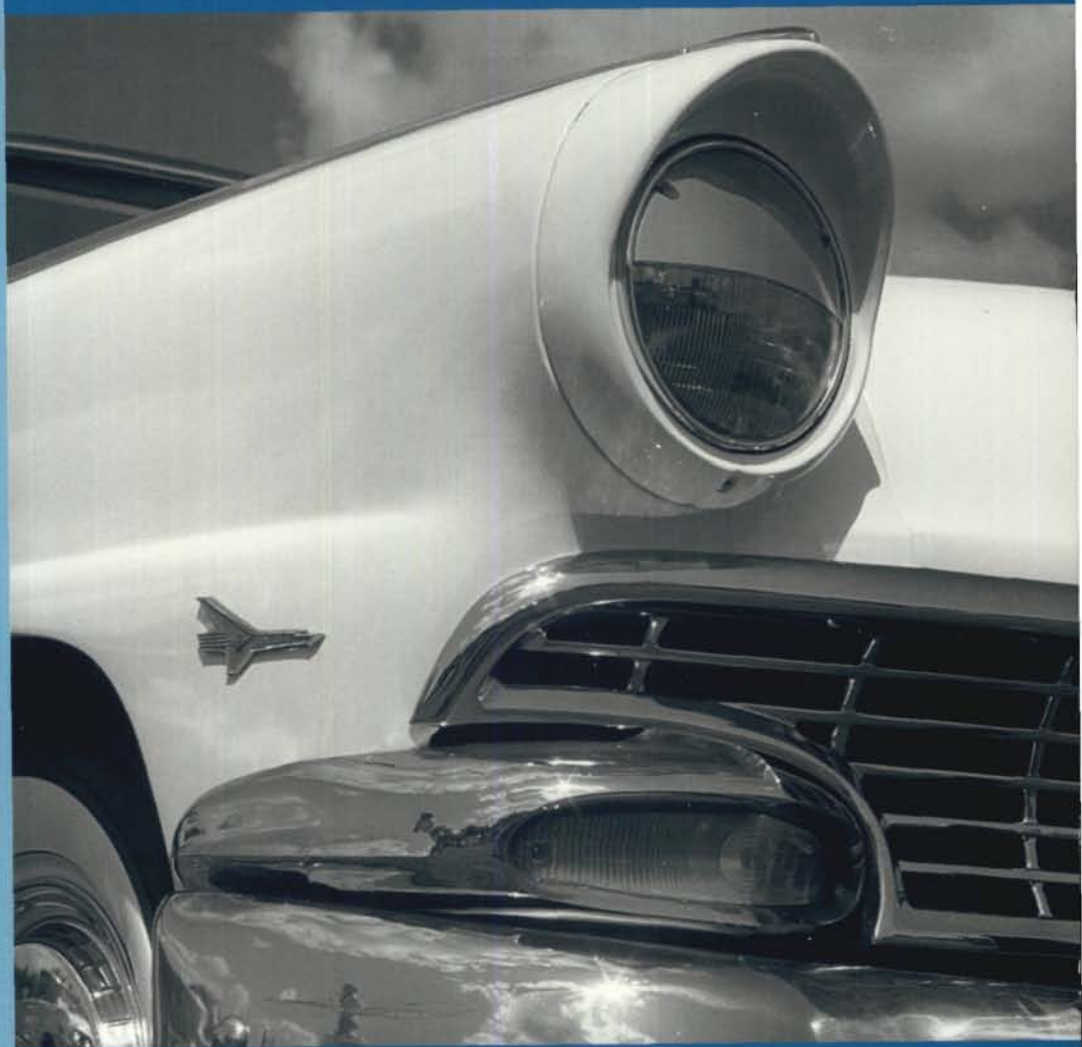
A Journal of Political Economy



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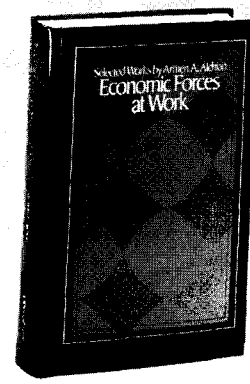

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Armen A. Alchian is professor emeritus of economics at UCLA.

Ronald H. Coase has been a senior fellow in law and economics at the University of Chicago Law School. He was awarded the Nobel Prize in economics in 1991.

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1956 Ford Fairlane
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Autonomy and Automobility

LOREN E. LOMASKY

Years before the automobile evolved into a transportation necessity, before multilaned asphalt replaced meandering muddy ruts, intrepidly pioneering motorists took to the roads for pleasure. Today tens of millions drive for pleasure, but increasingly it is a guilty pleasure. From a multitude of quarters, motorists are indicted for the harms they leave in their wake. Drivers generate suburban sprawl, exacerbate the trade deficit while imperiling national security, foul lungs and warm the atmosphere with their noxious emissions, give up the ghosts of their vehicles to unsightly graveyards of rubber and steel, leave human roadkill behind them, trap each other in ever vaster mazes of gridlock and, adding insult to injury, commandeer a comfy subsidy from the general public. Only the presence of unconverted cigarette smokers deprives them of the title Public Nuisance Number One.[1]

Barring a radical reengineering of America, we will not soon toss away our car keys. As the primary vehicles for commuting, hauling freight, and general touring, cars (and trucks) are here to stay. But as the automobile enters its second century of transporting Americans from here to there, it is increasingly dubbed a public malefactor, and momentum grows for curbing its depredations. Construction of significant additions to the interstate highway system has ground to a halt. Designated lanes on urban roads are declared off-limits to solo motorists. Federal Corporate Average Fuel Efficiency (CAFE) standards require automakers to eschew selling vehicles as

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1. Among the more comprehensive critiques are Mumford (1964), and Freund and Martin (1993). The campaign against the automobile is not confined to the United States; see "The Car Trap" (1996).

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capacious as motorists may wish to buy and instead to alter their mix of products to emphasize lighter, less gasoline-hungry cars. Taxes on fuel have been increased only modestly, but if critics of the hegemony of the automobile have their way, America will emulate Europe, pushing the tax up by a dollar or more per gallon. Funds thereby generated will not be designated for motorist services—such earmarking is precisely what has exacerbated the current plague of overautomobilization—but will instead be directed toward more mass transit, pollution relief, and research on alternate modes of transportation.[2] Some argue that employer-provided parking should be taxed as income to the employee or disallowed as a business expense to the provider. Others advocate following Amsterdam's lead, barring nearly all automobiles from entry into the center city. Moral suasion supplements policy proposals. In the name of social responsibility, individuals are urged to carpool or avail themselves of public transportation, scrap their older, fuel-intensive vehicles, and eschew unnecessary automobile trips.

Why this assault on the automobile? I have no wish to deny that it occurs at least in part because some of the critics' charges are true. Automobile carnage is indeed dreadful. The number of people killed each year on our roadways far exceeds the total who succumb to AIDS. Automobiles do pollute, all to some extent, some much worse than others. The cost of petroleum imports into this country exceeds the amount of the entire national trade deficit. And anyone who has ever been trapped in rush-hour gridlock, fuming inside at the delay while being engulfed by the fumes outside spewing from ten thousand tailpipes, knows that the simple job of getting from here to there in one's automobile can be the most stressful part of the day. Cars are not always "user-friendly."

But all these criticisms seem insufficient for explaining the intensity of opposition directed toward the automobile. Any large-scale enterprise entails costs, and so a critique that merely reminds us of the nature and extent of these costs is only half useful. Also required, of course, is a statement of the benefits derived from the enterprise, and a plausible accounting of whether the benefits exceed the costs. Identifying and measuring the costs and benefits of automobile usage pose very difficult methodological problems that I shall not consider here. I do note that the overwhelming popularity of the automobile is itself prima facie evidence that from the perspective of ordinary American motorists, the benefits of operating a motor vehicle exceed the concomitant costs. Just as theorists speak of people "voting with their feet," we can count those who vote with their tires. And this vote is overwhelmingly proautomobile.

Critics may contend, though, that the election has been rigged. They

2. See, for example, Hensher (1993).

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can maintain that the absence of public transportation and compact neighborhoods in which commerce, industry, and housing are integrated forces us so often into our cars. People might like to be able to purchase a loaf of bread without buckling their seat belts, but in many parts of the country they cannot. And even if each of us values the options and mobility that automobile transport affords, we might devalue yet more the stress, delay, and pollution imposed on us by others. Private use of automobiles so understood would approximate game theory's Prisoner's Dilemma, an interaction in which each player acts in his own rational self-interest but all parties are worse off than they would have been had someone impelled them to choose otherwise. And the critic contends that some such requirement, in the form of regulation or increased taxes or outright prohibitions, is needed to escape the tyranny of the automobile (see Hensher 1993, and Freund and Martin 1993).

The critic's case has at least this much merit: a purely behavioristic appraisal of automobile usage is insufficient for evaluating its normative status. We need also to think more intently about how to classify and understand as a distinctive human practice the action of *driving a car*. Opponents of the automobile argue that the most telling way to understand this is by equating the act with *creating a public bad*. I shall dispute that appraisal. My focus will not be on the many and varied instrumental uses to which the automobile is put (driving to work, carpooling the kids, buying groceries), though in no way do I mean to disparage these. Rather, I shall concentrate on automobility's intrinsic capacity to move a person from place to place. As such, automobility complements *autonomy:* the distinctively human capacity to be self-directing. An autonomous being is not simply a locus at which forces collide and which then is moved by them. Rather, to be autonomous is, minimally, to be a valuer with ends taken to be good as such and to have the capacity to direct oneself to the realization or furtherance of these ends through actions expressly chosen for that purpose. Motorists fit this description. Therefore, insofar as we have reason to regard self-directedness as a valuable human trait, we have reason to think well of driving automobiles.

I am not maintaining, of course, that all and only motorists are autonomous, that someone persuaded by the slogan "Take the bus and leave the driving to us" thereby displays some human deficiency. A liberal society is one in which people pursue a vast diversity of goods in myriad ways, and this variety accounts for a considerable share of that society's attractiveness. So even if driving a car is an intrinsically worthwhile action, it does not follow that declining to drive is suspect.

But neither am I claiming that automobiles are simply one among thousands of other products that individuals might, and do, happen to

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find attractive in a cornucopia of consumer goods. The claim is stronger. Automobility is not just something for which people in their ingenuity or idiosyncrasy might happen to hanker—as they have for Nehru jackets, disco music, hula hoops, pet rocks, pink flamingo lawn ornaments, Madonna, and "How many...does it take to change a lightbulb?" jokes. Rather, automobile transport is a good for people in virtue of its intrinsic features. Automobility has value because it extends the scope and magnitude of self-direction.

Moreover, the value of automobility strongly complements other core values of our culture, such as freedom of association, pursuit of knowledge, economic advancement, privacy, and even the expression of religious commitments and affectional preference. If these contentions have even partial cogency, then opponents of the automobile must take on and surmount a stronger burden of proof than they have heretofore acknowledged. For not only must they show that instrumental costs of marginal automobile usage outweigh the corresponding benefits, but they must also establish that these costs outweigh the *inherent good of the exercise of free mobility.*

Wheels of Fortune: Movement, Choice and Human Potential

Concern about automobiles may be a modern phenomenon, but analysis of the distinctive nature of automobility is not. For Aristotle, being a self-mover was the crucial feature distinguishing animals from plants and, thus, higher forms of life from lower. A more basic distinction separates the organic realm from that which is lifeless. Living things have an internal animating force, *psyche.*[3] The customary translation is "soul," but in the context of Greek biology that is misleading. For us, "soul" tends to carry a theological and therefore elevated sense, but in classical Greek thought it marks the divide between inert things and those imbued with a vital principle.[4] Psyche appears at three levels. The lowest is vegetative soul. Plants are more than just things insofar as they are not merely acted on but also do something. Specifically, they ingest food, metabolize, and reproduce. At the highest level is the rational soul, the intelligence exhibited among the animals only by humans. Between, and crucial to this discussion, is animal or sensitive soul. Level-2 psyche has the capacities of level-1 psyche (and level-3 psyche those of level-2) plus two further features. Unlike plants, animals perceive and they move themselves.

3. Aristotle's most extended discussion of *psyche* is in *De Anima*. The secondary literature is vast. A concise and comprehensible overview of Aristotelian philosophy is Ackrill (1981).

4. See "psyche" entry in Edwards (1967).

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Perception and movement are enumerated as two qualities but, as set out in *De Anima*, they are to be understood as strongly complementary. Because plants are stationary (or, if mobile, as are the seedpods of some species, carried where they go by external forces), they have no need to perceive. If the wheat is not going anywhere, then it cannot benefit from seeing the swarm of locusts about to descend on it. Aristotle expressed this idea in the teleological language of *purpose* and *natural function* that pervades his metaphysical awareness, but essentially the same point could be made in contemporary terms of inclusive evolutionary fitness. Plants do not perceive because (a) no purpose would be fulfilled by their perceiving or (b) evolution does not select at that biological level for perception. The locusts do perceive, however, as their survival depends on becoming aware of and directing themselves toward potential items of food. We can also state the connection in reverse order: if a being does not perceive the difference between *here* and *there*, then its having the capacity to direct itself there rather than here serves no purpose.

Plants are alive, but their "quality of life" is low (thus the comatose individual referred to as a "human vegetable" and the inert TV-watching "couch potato"). They function in the world but in complete obliviousness to it. Lacking consciousness, the cucumber has no perspective from which there is a "what it is like to be a cucumber." Plants *are*, and in a restricted sense *do*, but in terms of nearly all that we take to be of value in life, they are nullities.

Animal life differs, and the difference lifts the organism above nullity status. To perceive is to assimilate in some measure the world to oneself. And to be a self-mover is to situate oneself in the world in accordance with one's own desires. Perception plus mobility are prerequisites of *agency*. Patients are beings to whom things happen, but agents act. At some level of awareness agents distinguish between goods and bads and endeavor to direct themselves toward the former and away from the latter. For animals, this direction involves instinctive or acquired responses to pleasure and pain. For human beings action takes on additional complexity. We do not merely react to stimuli in our environment. Instead, we deliberate among available alternatives conceived of not only as pleasing or displeasing but also in terms such as "dishonorable," "what justice demands," "liable to make me famous," "chic," and so on. At this level it is proper to speak in a nonmetaphorical sense of *choice*. Aristotle maintains that animals or young children do no genuine choosing. In choosing, we act to give expression to our settled conceptions of how we want to direct ourselves. Our choices flow from and redound upon our virtues and vices. We do not offer moral appraisals of beings incapable of choice; unlike normal adult human beings, neither infants nor animals can be brave or wicked or temperate.

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The conception of motion has a wider scope than traveling from place to place. We retain residual traces of this broader meaning in expressions such as "a moving experience" and in the etymological history of "emotion," but in the philosophical language of the Greeks the more inclusive sense is primary. Any transformation of a subject from a state of potentiality with regard to some quality to the actual realization of that quality is deemed motion.[5] So going from here to there constitutes movement, but so also do an organism's growth, someone's coming to know something, the development of a faculty, and so on. In an Aristotelian universe, motion is ubiquitous because everything tends to progress toward the highest possible self-realization. For simple inorganic forms like a rock, this potential is correspondingly simple, involving only the capacity to fall when unsupported. In organisms the transition from potency to act is more complex. The oak, for example, moves to its actuality through the complex chain of maturation that commences from the acorn stage. For animals, such self-realization incorporates consciousness and self-propulsion. Human actualization adds deliberation and choice. Only for a completely actualized being would movement be otiose (or counterproductive). And indeed, Aristotle hypothesizes that a god dubbed the "Unmoved Mover" occupies the pinnacle of the metaphysical hierarchy because in its enduring perfection it has transcended all reason to change, whereas anything else in the universe, insofar as it realizes any of its potential, is approaching to some greater or lesser degree, consciously or unconsciously, this state of full actualization. Encountering Greek philosophical thought, Christians applied this concept of an unchanging perfection to the Book of Genesis's Creator of Heaven and Earth.

Movement, therefore, does not simply describe getting from here to there; it has normative richness. To move is to progress—though, of course, it can also be to backslide. Only stasis is morally neutral, and ours is a dynamic universe. The greater the variety of dimensions through which an individual transforms itself and things it encounters, the greater the scope for evaluative concerns. The grounds on which human beings appraise themselves and their fellows will be much richer than, say, the standards applied to horses or bottles of wine or the performance of machines. For people, there is not only a better or worse but a *chosen* better or worse toward which we deliberately direct ourselves. Intelligent automobility is crucial to the elevated status of human beings vis-à-vis other beings.

5. *Physics* is the Aristotelian work that addresses the investigation of being qua subject to change or motion.

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A Philosophical Detour

If you bump into me and cause me to lurch from my path, it is clear that my behavior is not that of a self-mover. Less clear, though, is the case in which you glower menacingly at me as you approach down the sidewalk, thereby "persuading" me to step aside. Or suppose that yesterday when you hypnotized me you implanted within me a suggestion that I always make way for you, and so today when I see you approaching I not only defer but am pleased to do so out of concern for your well-being. In the latter two instances I have, in a sense, moved myself. Not only are the muscle contractions that impel my legs the contractions of *my* muscles, but they are preceded by mental activities that can be characterized as *my decision* to move in that way. But that characterization demands qualification. The action is mine, but in its initiation it is also yours by virtue of the threat or hypnotic implantation. It is at least as much a *being done to* as it is a *doing,* and so it qualifies as agency only in a restricted sense.

The many species of such qualified action—or "action"—raise notoriously vexing problems of moral responsibility. Aristotle considers them with regard to the dichotomy voluntary-nonvoluntary and concludes, not all that helpfully, that they are "mixed," though perhaps to be classified closer to the voluntary than the nonvoluntary.[6] The issue is not only theoretical but also sharply practical: Do we blame (or praise) those who act under duress, extraordinary fear, rage, naïve suggestibility, exhaustion, ignorance, or similar other conditions that call into question their full authorship of an action? Lawyers and moralists wrestle with such issues. For purposes of this discussion it is not necessary to resolve these conundrums. Note however that the more qualified the action is with regard to the performer's agency, the less it redounds as either asset or liability to the individual's moral account.

Accountability enters crucially into human dignity. Insane or incompetent persons are not accountable for their doings, and that is symptomatic of their misfortune. We value full authorship of our own actions (or, noncircularly, authorship of the behavior of one's body) and fear conditions—manipulation, coercion, intimidation—that impede such authorship. Those who exercise such control over their actions are said to be *autonomous.*

Autonomy, literally "self-legislating," originated as a term applied to political units, distinguishing the independent ones from those governed by the laws of some other polity. In moral philosophy, autonomy acquired importance as an attribute of individuals in the writings of the eighteenth-century German philosopher Immanuel Kant.[7] Like Aristotle, Kant inquired

6. See *Nicomachean Ethics*, bk. 3.

7. See his *Groundwork of the Metaphysics of Morals* (available in numerous editions). A useful discussion of the nature and importance of autonomy is Dworkin (1988).

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into the conditions required for the existence of moral responsibility, but for him the universe in which human beings act had a significantly different look than the teleologically structured world of Aristotle, which was thoroughly hospitable to normativity. Newton and the new physics had depicted a deterministic order in which each event is the inevitable consequence of the nexus between universal causal laws and the antecedent conditions to which they apply. Whatever happens does so of necessity rather than caprice or randomness. But if that necessity holds for events in general, it applies to human actions in particular. We are as subject to the physical laws governing the cosmos as are galaxies and atoms. Therefore, our doings are in principle entirely explainable and predictable (depending on whether one is viewing them retrospectively or prospectively) in terms of these laws. But if conditions that obtained five minutes—or five hours, or five years, or five millennia—ago made it inevitable that at this precise moment I would perform Action A, it would seem that I am not free with respect to performing A. It *had to happen* and, thus, I *had to do it.* This determinism may seem to deliver a crushing blow to conceptions of human agency and moral responsibility. If the doing of A was sealed long ago, if even before I was born it was inscribed in the history of the cosmos as an inevitability, then my participation in its unfolding would seem to be purely passive. I can no more be genuinely responsible for its occurrence than I can be for my eye color or an eclipse of the sun. In none of these cases can I change the course of events.

This problem of free will and determinism is one of the most vexing in philosophy. In Kant's day, it loomed very large. If the whole universe is one giant machine obeying its own internal laws, how can we be other than machine cogs ourselves? Kant's way out was drastic. He salvaged human freedom by imposing on persons a metaphysical schizophrenia. We simultaneously belong to the phenomenal universe subject to cause and effect and to a purely intelligible realm, the *noumenal order,* regulated not by mechanical laws of physics but by the normative laws of reason. In the former realm we are self-movers only in a relative and incomplete sense; every action has a cause that necessitated it, and that cause has a cause, and so on ad infinitum. As phenomenal beings we are no more than protoplasmic machines in a thoroughly mechanistic universe. But as noumenal beings we can determine ourselves in accord with self-imposed dictates of reason, thereby achieving autonomy. Insofar as we enjoy autonomy, we are free beings and possess a worth and dignity that set us apart from the realm of necessity.[8]

Ironically, although almost no contemporary moral philosophers accept Kant's complex "two worlds" metaphysics, his guiding idea that autonomy is central to our special moral status as persons informs much modern moral

8. Immanuel Kant, *Groundwork of the Metaphysics of Morals,* Sec. 3.

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thinking. Its effect appears in quarters as disparate as the existentialist insistence that we are beings with no predetermined essence and thus privileged—or condemned—to define ourselves through our own free choices,[9] John Rawls's (1971) influential conception of justice as principles that would be autonomously chosen by free and equal rational beings deliberating behind a veil of ignorance, and the doctrine of informed consent that dominates contemporary medical ethics.[10] I shall not attempt to sort out these and other variants on the theme of autonomy. It is worth noting, though, that much of the contemporary concern for autonomy is continuous with and indeed has tended to replace the earlier emphasis in moral philosophy on the centrality of liberty in human affairs. The writings of John Stuart Mill provide the locus for much of this transformation.

In his classic *On Liberty*, Mill sought to provide a principled basis for opposition to the imposition of conformity via law and social custom. He trotted out a whole array of arguments to demonstrate that restrictions on liberty are inimical to scientific advance, accumulation of wealth, and other requisites of human happiness. Most of these appeals invoke instrumental considerations of the sort familiar from standard economic analysis. But in perhaps the most important section, the chapter entitled "Of Individuality, as One of the Elements of Well-being," he presented a different sort of argument, predicated on the intrinsic worth of what I have called full authorship of one's actions, Kant called autonomy, and Mill referred to as individuality:

> He who lets the world, or his own portion of it, choose his plan of life for him, has no need of any other faculty than the ape-like one of imitation. He who chooses his plan for himself, employs all his faculties. He must use observation to see, reasoning and judgment to foresee, activity to gather materials for decision, discrimination to decide, and when he has decided, firmness and self-control to hold to his deliberate decision. And these qualities he requires and exercises exactly in proportion as the part of his conduct which he determines according to his own judgment and feelings is a large one. It is possible that he might be guided in some good path, and kept out of harm's way, without any of these things. But what will be his comparative worth as a human being? It really is of importance not only what men do, but also what manner of men they are that do it. (Mill [1859], 1989, 59)

9. See, for example, Sartre ([1943] 1956).

10. An illuminating discussion is Childress (1982).

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One cannot reduce "what manner of men they are that do it" to statistics of net wealth per household or GDP growth from one year to the next; such achievements matter less than the character one creates in and for oneself. Retaining captaincy of one's soul (if not always mastery of one's fate) is essential to authenticity and a self genuinely deserving of esteem. Conversely, to be prodded by others along paths they have cleared toward goals they have set is servile. It demeans the dignity of the individual. To live well is to live in a manner that one has made distinctively one's own.

Autonomy so understood incorporates Aristotelian self-moving but goes beyond it. A self-mover can be one participant among thousands in a lengthy parade, each following in lockstep the one who goes before, not knowing or caring where he is headed just so long as he ends up in the same place as all the others. But an autonomous individual is not content to leave the course of the march to the determinations of others (or to chance). He has a conception of a good-for-him that he may not have created ex nihilo but which he actively endorses. And in its service he prioritizes, deliberates, and selects means judged appropriate to ends. He acknowledges personal responsibility for those ends and means. If he succeeds, the outcome is in a full sense his success rather than the vagaries of fate playing kindly with him; and if he fails, that outcome is also lodged at his doorstep rather than that of the parents who toilet-trained him, the teachers who instructed him, the community that socialized him, the politicians who competed for his allegiance, or the preachers who offered him slide shows of heaven. Any or all of these persons may have provided elements of value that he has incorporated into his projects, but the compound he concocts from them is his.

It would be overly contentious to maintain, as some exponents do, that without autonomy one fails to lead a fully human life. Countervailing virtues grace traditional modes of life. Individuals do not so much craft these virtues for themselves as they receive and don them as hand-me-downs from others. The monk's life of humility and abasement and the traditionally female roles of nurturance and support within the family display their own quiet dignity. Still, no mode of nonautonomous living fully expresses individuated human agency or so firmly opposes servile conformism. To cite Mill again:

> In our times, from the highest class of society down to the lowest, every one lives as under the eye of a hostile and dreaded censorship. Not only in what concerns others, but in what concerns only themselves, the individual or the family do not ask themselves—what do I prefer? or, what would suit my character and disposition? or, what would allow the best and highest in me to have fair play, and enable it to grow and thrive? They ask themselves, what is

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> suitable to my position? what is usually done by persons of my station and pecuniary circumstances? or (worse still) what is usually done by persons of a station and circumstances superior to mine?... It does not occur to them to have any inclination, except for what is customary. Thus the mind itself is bowed to the yoke. ([1859] 1989, 61)

Autonomous people "Just Say No" to the yoke.

Commuting and Community

The automobile, definitionally, promotes automobility. The complementarity of autonomy and automobility is only slightly less evident. In the latter part of the twentieth century, being a self-mover entails, to a significant extent, being a motorist. Because we have cars we can, more than any other people in history, choose where we will live and where we will work, and separate these two choices from each other. We can more easily avail ourselves of near and distant pleasures, at a schedule tailored to individual preference. In our choice of friends and associates, we are less constrained by accidents of geographical proximity. In our comings and goings, we depend less on the concurrence of others. We have more capacity to gain observational experience of an extended immediate environment. And for all of the preceding options, access is far more open and democratic than it was in preautomobile eras. Arguably, only the printing press (and perhaps within a few more years the microchip) rivals the automobile as an autonomy-enhancing contrivance of technology.

No one who has been caught in rush-hour gridlock will maintain that commuting to and from work is an unalloyed joy. Competing with tens of thousands of other motorists for scarce expanses of asphalt reminds one of the Hobbesian war of all against all. For critics of the automobile this complaint is not a negligible point. But neither are its implications entirely clear-cut. Just as worthy of notice as the unpleasantness of stop-and-go commuting is how many people voluntarily subject themselves to it. Have they not realized how much time they are wasting in overly close proximity to their steering wheels? Such inadvertence is not plausible. Evidently, people who, individually and collectively, could have devised for themselves residential and occupational patterns not incorporating lengthy commutes chose to do otherwise. In their judgment, the costs of commuting are compensated by the benefits thereby derived. The more the critics emphasize the magnitude of the costs, the more these critics underscore, often unwittingly, the extent of the benefits.

Commentators from the Greek philosophers to Adam Smith to Karl Marx have noted that the nature of the work one does largely shapes the

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quality of life one enjoys. For nearly all of us, to do work suited to oneself in a satisfactory environment is a great good, whereas to perform alienating labor under unfriendly and unhealthy conditions is a correspondingly great evil. Similarly, to reside in a comfortable and functional dwelling situated in a neighborhood one finds hospitable is also a considerable good. For most people throughout human history, neither occupation nor place of residence has afforded more than a negligible range of choice. One did the work one's father or mother did, or to which one had been apprenticed, or the kind of work available in that place. And one lived near the workplace.

The increased affluence and openness of liberal capitalist society vastly expanded the range of choice. But the coming of the automobile essentially separated the choices. Previously one lived either near one's work or else on a commuter rail line. But the geography of the New York, New Haven, and Hartford tracks did not bind motorists. Depending on how much time they cared to invest in transit, they could live at a considerable distance from their workplaces, yet emancipated from the rigidities of mass transit. Cultured despisers of the idiocy of suburban existence can and do decry this circumstance, but millions of Americans (and, increasingly, the rest of the world) disagree. Even if one believes for aesthetic or other reasons that row upon row of bungalows or ersatz Tudor houses miles distant from the city or industrial area to which they are connected by roadways represent unattractive neighborhoods, one cannot deny that they are genuine objects of choice for those who live there. People, we might say, have a right to banality. To respect the autonomy of persons is to acknowledge that expanding their options for combining work and place of residence is as such a plus.

Nineteenth-century socialist reformers decried the enhanced ability of industrial capitalism's factory system to exploit workers. Human labor, they charged, had become no more than an appendage of mill or machine. Although one could reasonably respond (as Friedrich Hayek [1954] famously did in *Capitalism and the Historians*) that workers who voluntarily abandoned their rural domiciles for the factory town did so only because they themselves regarded the move as a net improvement, one must nonetheless concede that their situation was not enviable. They may have enjoyed a higher standard of living than that available to them on the farm, but their work was grueling and their opportunities for self-directed choice minimal. Against the perceived oppression of industrial society, the reformers contrived various nostrums, one family of which, now mercifully defunct, oppressed millions of unfortunate souls throughout most of this century.

No syndicalist scheme or string of workers' cooperatives remotely approaches the automobile as an emancipatory instrument. Insofar as it extended the feasible range of commuting between residence and labor, the coming of the motorcar augmented the bargaining power enjoyed by

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workers. A company town offers little scope for alternate employment opportunities. Changing jobs very likely requires changing place of residence, and exit costs of both pecuniary and nonpecuniary sorts may render that prohibitive. However, widespread automobile ownership dramatically extended the geographical radius of possible employment venues. Hence, the market for labor came more closely to approximate the economists' model of many sellers and many buyers. In theory, under a legal regime of free contract, workers always enjoyed the right to terminate their employment when they wished to do so, but in practice the exercise of this liberty often proved discouragingly costly. Automobility significantly lowered those costs. The country music song "Take This Job and Shove It" became something of an anthem for the disaffected at a time when car ownership had become almost universal. Musical aesthetics aside, those who value choice not only formalistically but as the existence of genuine live options must appreciate this alternative. Detroit has done more for the liberation and dignity of labor than all the Socialist Internationals combined.

One can also observe liberation by viewing the employment-residence nexus from the other direction. The ability to choose where one will live makes a considerable difference in the exercise of self-determination. Life in the suburbs is not inherently better than life in the central city, but it is different. To the extent that one possesses a real opportunity to choose between them, one can give effect to significant values that shape the contours of a life. A city may offer ready access to arts and education, a succession of ethnically diverse neighborhoods, a feeling of drive and vitality, an ambience that "swings." But cities are often dirty, expensive, and dangerous. Exurban life may provide peaceful neighborliness, gardens and green spots, family-oriented activities that take place in the home or the mall. But exurbs are often antiseptic, provincial, and stultifying. To choose the one is to relinquish (some of) what the other affords. So which is the better alternative? People must answer for themselves based on their own conceptions of what matters most. To the extent that one has geographical mobility, the question is answered by an act of positive choice rather than through inertia or extraneous constraints such as the location of one's place of employment.

Choice of residence serves as a major avenue for Americans to exercise their right to free association. Choosing a neighborhood is the macrolevel correlate to choosing one's friends. One thereby decides with whom one will live. And perhaps even more important, one decides with whom one will not live. In contemporary society, "leaving home" signifies a full coming of age and the concomitant entitlement to direct one's own projects as an adult. But then comes the necessity of finding and making a home in a neighborhood to which one has a tie at least in part because one has freely chosen to live there rather than somewhere else. This choice too signifies and gives

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effect to one's values. Some people prize a high degree of homogeneity of race or religion or age or economic class among those with whom they will most frequently associate. Others prefer a heterogeneous diversity of different ages, skin tones, and backgrounds from which casual acquaintances and intimate friendships will emerge. Considering whether one of these preferences deserves more admiration than the other carries us away from the theme of this essay, but even if one regrets that some people choose to segregate themselves from those who somehow differ—or conversely, that some defect from tightly knit ethnic communities—an ethic that endorses autonomy must acknowledge that, the content of individual choices aside, it is good that people can make up their own minds and then act on their decision about where to live.

More flexibly and more frequently than anything else, cars get us from one place to another. If we can conveniently drive to a place consistent with work and other commitments, then it passes the first test of eligibility as a possible place of domicile. (Thanks to that other great choice-enhancing device, the microchip, this situation may change as more and more individuals telecommute.) Although critics of the automobile also frequently criticize what they take to be a dreary suburban sameness, within reasonable commuting distance of virtually every urban center in this country are dozens of towns and neighborhoods that differ significantly one from another—perhaps not in factors these critics take to be momentous but certainly along dimensions that the men and women behind the steering wheels consider important. From the perspective of autonomy, their criteria deserve respect.

Mobility and Knowledge

For much the same reasons that automobility and autonomy are good things, so too is knowledge. Like self-moving, knowing affords us a firmer grip on our world. Indeed, choice and knowledge complement one another. A simple example will help illustrate their relationship.

Consider a shopper in a supermarket deciding whether to buy the can on the left or the can on the right. Neither can has a label, so it is anyone's guess whether one of the cans holds tuna fish or shoe polish or bamboo shoots. How much would a shopper value the freedom to choose between them? The obvious answer is "not much." The minimal ability to distinguish them as "left can" and "right can" does not afford enough information for individuals to judge which is more likely to serve their ends. The "choice" is otiose.

Now suppose that the label is restored to one of the cans. The shopper now knows it to contain mushrooms. The value of choosing has gone up.

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The magnitude of the increase depends on how this added bit of knowledge relates to the shopper's preferences. If he either strongly likes or dislikes mushrooms, then he has a basis for picking between the cans, but not as good a reason as he would have if the other can were labeled, too. And further knowledge concerning particulars of taste, nutrition, quantity, and so on renders the choice one in which the shopper can give effect to his own distinctive values. Choice without knowledge is blind; knowledge without choice is impotent.

Automobiles enhance mobility, and mobility enhances knowledge. Recall the discussion of the relationship between self-moving and perception in Aristotle's biological theory. As the area in which people can direct their self-aware movements increases, so too does the range of their knowledge-gathering capacities. The knowledge in question is, in the first instance, local knowledge. By traveling through, around, and within a place, one comes to know it in its particularity. This kind of knowledge has no very close substitute. I may have read a score of books about Paris, but if I have never visited the City of Lights, if I have never traversed its streets and bridges and marketplaces, then I could not truly claim, "I know Paris." One can no more reduce knowledge of a place to possessing many facts about that place than one can reduce knowing another person to having read a very detailed resume. Philosophers often distinguish between *knowledge by description* and *knowledge by acquaintance*. To acquire the latter, one often needs mobility.

Of course automobiles are not the only form of transportation that serves to increase local knowledge, and for some types of local knowledge they may serve poorly. One such case is that described in the preceding paragraph: for acquiring up-close knowledge of a city like Paris, shoes serve better than tires. All forms of transportation—from walking to bicycling to trains, buses, ships, and airplanes—enhance knowledge. But with the possible exception of the motorcycle, another means of transportation assailed by no shortage of critics, none combines local maneuverability with extended range to the degree that the automobile does. The train can move me from one city to another at intermediate distance and afford me the opportunity of viewing the terrain in between. But it allows only a limited number of stops along the way, the speed may be slower or faster than one would wish for optimal information gathering, and the route will be exactly the same on the thousandth trip as on the first. Airplanes excel for speed, but everything between points of departure and destination is indistinct. Walking is a wonderful way to observe a neighborhood, but inadequate to take in even the opposite end of a village, let alone a state or country. For genuine exploration at long or intermediate range, the car dominates all alternatives.

How much weight should one give this sort of knowledge? The question

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deserves an answer. Few of the automobile's critics have a word to say about the knowledge-enhancing aspects of automobility, either because they have never considered the automobile from the perspective of information gathering or because they implicitly suppose that what one learns while behind a steering wheel is trivial. But these critics do not represent the population at large. They are intellectuals and information processors of one stripe or another, most comfortable with information that can be synthesized in books or graphs or computerized databases. They tend to depreciate information that can't be measured, quantified, and represented symbolically. But the information to be gained from reading a history book or running a regression is not the only sort that individuals can use effectively in their pursuits. Knowledge need not be grand or profound to have value in itself and to complement choice. By driving north along the lake to see how the autumn leaves have turned and whether the Canadian geese are still milling or have flown, I may gain an inherently worthwhile experience. Driving through the various neighborhoods of a city reveals where the bakeries, hairdressers, and Thai restaurants are located; who is having a garage sale this week; and which parts of town are becoming distinctly seedier. Teenagers cruising the "main drag" are conducting an epistemological mission motivated by the hope of sniffing out the whereabouts of others of a desirable age and gender. And even the stereotypically boorish Bermuda-shorts-clad tourists with their vans, videocams, and surly children in tow may actually be uplifted by the sights of the Civil War battlefield or seaside to which they have driven.

When the range within which one moves about becomes extended, so too does the range of one's potential knowledge. The automobile is the quintessential range extender, not only by lengthening the trips one can take but also by multiplying the number of available routes. Knowledge by acquaintance has been emphasized in the preceding discussion, but automobility also extends one's ability to acquire other kinds of knowledge. Cars go not only to malls and theme parks but to libraries, universities, and museums. Cars provide regular access to urban centers of learning to those who live many miles distant. The traditional derogatory image of the unlettered "country bumpkin" has been rendered increasingly obsolete by new technologies—telephone, television, computer and, not least, the automobile.

The Wheels of Privacy

Privacy complements autonomy. Someone who is private has a life of his own. That is, he is not entirely defined and constrained by a public persona. The capacity to be self-determining requires some quantum of privacy, whereas being an adjunct to a greater whole or an organic part of an

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organism does not. Individuals are private only to the extent that some part of their personas belongs primarily to them and not to the world at large. Being inappropriately viewed during a moment of intimacy or vulnerability constitutes one of the most basic encroachments on privacy. In an extended sense, privacy incorporates limitations not only on perceptual access but also on the knowledge or control others may have over oneself.

What constitutes an invasion of privacy is not fixed by our nature as human beings but is relative both to more or less arbitrary convention and to the far-from-arbitrary conditions that govern the possibility of forging an identity that is distinctively one's own. "A man's home is his castle" expresses one early manifestation of this impulse. The king is powerful and the king reigns, but in one little corner of the realm the commoner, not the king, enjoys (quasi) regal prerogatives. A right not to be subject to search and seizure without due process of law and a right not to be obliged to incriminate oneself are further manifestations. They express the conviction that personal dignity imposes limits on mandatory subjection to the scrutiny of others.

Some ancient conceptions of privacy endorsed a radical withdrawal from one's fellows. We should view the hermit or anchorite not as essentially a misanthrope but rather as someone who by separating himself from other human beings thereby draws closer to his God. (For Christians, Jesus in the wilderness provides the paradigmatic instance; there are many others.) Monasticism constitutes a slightly less radical version: voluntary sequestration with a few like-minded others away from the main crossroads of urban life. From Qumran by the Dead Sea to David Koresh at Waco, sectarians have acted on the belief that they could achieve a greater inner and external freedom by isolating themselves from the majority culture. When that majority culture nonetheless forcibly impinges on them, results typically are tragic.

Previously I have focused on the value to individuals of the capacity to approach and enjoy particular goods. The concern for privacy underscores the concomitant importance of the capacity to distance oneself from threats. If too many eyes are on me where I am, then I shall enhance my privacy by moving out of the spotlight of public scrutiny. For most of us the relevant degree of privacy rarely involves isolation from all others but usually does require the ability to exercise a significant degree of discretionary control over who will have access to one's body and mind. Adolescents who go out to "do nothing" thereby claim a measure of privacy vis-à-vis their parents; a fishing trip may have less to do with baiting fishhooks than with taking oneself off invasive social hooks.

For twentieth-century American society, the automobile serves as the quintessential bastion of privacy. For many of us the Honda, not the home,

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is the castle. Ironically or not, those minutes between home and office on a freeway clogged past capacity with multitudes of other cars may be one's most private time of the day. (I do not mean to slight the benefits of the other great solitude-enhancing device of our culture, the bathroom.) Even those who love their spouse and children, delight in the company of friends, and work compatibly alongside colleagues may nonetheless relish a short time each day to be alone. Such interludes do not indicate an antisocial impulse. Intermediate periods of solitude can fuel bouts of gregariousness and sociality just as an astringent serves to clean the palate between sumptuous courses.

Social planners are wont to gnash their teeth at the number of motorists who could arrange to commute by car pool but instead "inefficiently" take up roadway space with solitary-occupant cars. Diamond lanes and other inducements have only a limited effect on the average occupancy. This outcome may be viewed as a failure of policy, but it can also be seen as a reasonable and in some ways estimable response to the valid human desire for privacy. "It is not good for the man to be alone," says Scripture, but for those who live among a surfeit of others, it is sometimes very good indeed to be alone. The closing of the car door can provide a welcome shutting out of the rest of the world, allowing a recapture of the self by the self—as opposed to its usual embeddedness in an array of intersecting public spaces. Car pools are not necessarily a bad thing; in demonstrable respects, we might be better off if more people doubled and tripled up before taking to the roads. Privacy in virtually all its forms, including that afforded by the automobile has significant costs. (Think of the private room versus the hospital ward.) I shall not inquire here whether the costs of automotive privacy exceed the benefits; my point is simply that driving solo has genuine benefits that go beyond merely instrumental facility in getting from here to there. Any unbiased cost-benefit analysis must acknowledge that privacy has a positive value and proceed from there.

Being alone is one aspect of privacy but not, I believe, the most central. More salient to privacy than the distancing of oneself from others is a (re)gaining of control over one's immediate environment. I may be surrounded by other people, but if I can determine to a significant degree what they shall be allowed to perceive of me and know about me and impose on me, then to that extent I have retained a private self. Surely one reason for people's fondness for their cars and for automobility in general is the control afforded over one's immediate environment. Drivers make choices by turning the wheel clockwise and counterclockwise, determining the external environment to which they will move themselves; by other manipulations they arrange the internal environment to their liking. Pushing one button turns on the radio. Pushing others changes the station, lowers the volume,

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turns off the radio and switches to the tape player. Individuals choose for themselves whether to listen to news reports, Beethoven, the Beatles, or nothing at all. Next to the switches for the stereo are those for climate control, windshield washing, blinking one's lights, and perhaps a cellular phone. (Because the last item supplies incoming as well as outgoing calls, an assessment of whether it extends or diminishes privacy is double edged.) The vehicle's make, model, style, color, and options are more permanent objects of one-time choice. Automobile reviewers write about "responsiveness." This has a limited meaning in the context of evaluating how a vehicle performs, but automobiles, unique among all forms of personal transportation, have a larger responsiveness. Individuals exercise control over the internal environment of their cars in a manner not possible with any alternate mode of getting around.

Contrast the privacy-enhancing features of the automobile with a typical (typical, that is, based on the author's recent experience) commute by public transportation. As one walks down the stairs to the subway, one's nostrils are greeted by a subtle aroma of urine and garbage. If it is rush hour many milling people clog the platform, and so one tries to be careful neither to knock nor be knocked into. When traveling will actually commence is not in one's own hands; it depends on whether the train is on time or delayed. Being able to sit is a matter of luck. So, too, is the company one will keep. A man of indeterminate years holding a hat in his hand treks through the train car by car. He begs the attention of the passengers, tells them that he has no job, no place to sleep, no money. Dope, he announces, has scrambled his brain. That confession probably is true; he twitches, smells bad, looks unhealthy. Some people drop a quarter into the hat, most don't. A few minutes later three kids come through, break into song for a mercifully brief period, smile, wait to get paid. The singing displays few aesthetic gifts, but the boys' smiles are rather sharklike. Maybe another quarter is dropped in another hat, maybe not. Between the bumpings of the car and the performances of these itinerants one may manage to read a few *New York Times* column inches. Eventually one arrives at one's destination.

Again, I am not arguing against mass transportation. In some urban settings it is the only realistic way to move a large number of people through small spaces in a reasonable amount of time. My point rather is that public transportation necessarily encroaches on privacy. On a New York City subway the encroachment tends to be great; with other modalities it may be considerably smaller. However great or small, though, it belongs on the debit side if one counts privacy as a credit. Working out the magnitudes is the tricky part, an exercise that will vary according to differences in individual temperament and preferences. But once we focus attentively on privacy, it will no longer appear obvious to us that rush-hour gridlock on highways is

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an unacceptably high price to pay for the opportunity to be one's own man or woman behind the wheel of one's own car. Appealing to popular practice is not decisive in these matters, if only because some extraneous force may perversely shape such practice, but it does adduce evidence. That millions of people who bear no obvious marks of incompetence elect to drive when they might otherwise at equal or lower financial cost to themselves employ some means of public transportation indicates that for them automobility is a positive good rather than a necessary evil.

The Road from Serfdom

I have argued that the automobile does not merit the opprobrium its critics have showered on it. My reflections have considered some very general features of automobile usage, which obtain across nearly the whole range of interactions between motorists and their machine. I could have discussed more specialized enjoyments of automobiles: exhilarating in the speed of a high-powered sports vehicle taken flat out, the enthusiast's loving application of wax to a cherished collector car, the teenage boy half buried under the hood of the beat-up Ford whose engine he is tweaking for one last little bit of extra performance. These are automobile dividends, too, but because they appeal to special tastes, I judged that their inclusion might distract from the primary normative significance of automobility. Even with regard to only general considerations, however, one has ample reason to maintain that the ethical status of automobility stands quite high.

Why, then, has motoring fallen under such a cloud? Why does ostensibly enlightened opinion regard it as a bane and a nuisance? Three possible reasons suggest themselves. First, although the critics acknowledge the range of goods afforded by automobility, they have identified accompanying evils that drastically outweigh the goods. Second, the critics may have been oblivious to the various autonomy-enhancing features of automobility. Third, they may have recognized these features but regarded them as having a much lesser status than I have claimed on their behalf or, indeed, even as negatively valued.

Critics have driven home the case against the automobile with lengthy recitations of the social ills it fosters. I listed several of them in the opening section of this essay: polluting the air and littering the landscape with rusting steel cadavers, dependence on foreign oil suppliers, gridlock, the multitude of bodies mangled each year in road accidents, and so on. Let us grant that each is an evil. Still, they are not intrinsic to automobility as such but undesirable side effects. In a proper accounting, one will balance them against the various goods for whose attainment the automobile is instrumental. The overwhelming popularity of automobility among ordinary

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shoppers, commuters, suburbanites schlepping around the kids, and Sunday drivers out for a spin offers presumptive evidence that people value these goods highly. Precise measures can be left to the econometricians and their professional kin. I shall confine myself to making two different points.

First, the cited ills do not support a general indictment of the automobile and attempts to roll back its use. Rather, the indicated remedy is to adopt policies that reduce spillover costs. Legislators should aim taxes and regulatory controls at the vehicles that pollute excessively or present more than normal dangers to others; differential pricing for peak and off-peak access to highways lies well within the capabilities of currently available technology; and so on.[11] Well-aimed attentiveness to particular avoidable costs is commendable; wholesale denunciations of automobility are not.

Second, the balance sheet of instrumental values and disvalues ignores the intrinsic goodness of automobility in promoting autonomy and complements of autonomy—such as free association and privacy. Even if purely instrumental calculations did not unambiguously display a positive balance in favor of automobility, its autonomy-enhancing aspects are so pronounced both qualitatively and quantitatively that any plausibly adequate normative evaluation of the status of automobile usage must give them primary attention.

Could the automobile's critics have failed to observe that cars support autonomy? If these effects were slight and subtle, that supposition might be reasonable. But when compared with alternate means of transportation the automobile stands out as the vehicle of self-directedness par excellence. To overlook this fact would be like visiting the mammal area at the zoo and failing to notice that the elephants are larger than the zebras, camels, and warthogs.

I am convinced that the automobile's most strident critics appreciate that automobility promotes autonomy—and that is precisely why they are so wary of it. Public policymakers have a professional predisposition to consider people as so many knights, rooks, and pawns to be moved around on the social chessboard in the service of one's grand strategy. Not all analysts succumb to this temptation, but many do. Their patron saint is the philosopher Plato, the utopian architect of the ideal Republic, who embraces propaganda campaigns ("Noble Lie"), eugenic breeding, radical property redistribution schemes and—most tellingly—rule exercised by people just like himself, the philosopher-kings. If one sincerely believes that one knows what is best, and if one benevolently desires to gift one's fellows with this

11. See, for example, Adler (1993), Cameron (1995), Calvert (1993), Harrington and others (1994).

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treasure, their obdurate insistence on continuing to do things in their own preferred way can be maddening. "I'll give you what's good for you," the policy specialist vows, first in the soft tones of a promise and then, after experiencing rejection, in the clipped cadences of a threat.

People who drive automobiles upset the patterns spun from the policy intellectual's brain. The precise urban design that he has concocted loses out to suburban sprawl; neat integration of work, residence, and shopping within compact, multipurpose developments gives way to bedroom communities here, industrial parks there, and malls everywhere in between. If people rode buses and trains whenever they could, less oil would be burned and fewer acres of countryside would be paved over. Perhaps the races and classes would mix more. Perhaps communities of an old-fashioned sort, where everyone knew his neighbor, would return. Perhaps the central city would come alive again in the evenings. Perhaps...but why go on? These lovely visions give way before the free choices of men and women who resist all blandishments to leave their cars in the garage. They wish to drive, and by doing so they powerfully express their autonomy, but their exercises of choice also have the effect of rendering the planners' conceptions moot. So the intellectuals sulk in their tents and grumpily call to mind utopias that might have been.

Although this essay was stimulated in the first instance by a conviction that the critics of the automobile had, at best, offered distinctly one-sided appraisals, my aim here has been to develop the positive case for the value of automobility, not to respond point by point to the items in the brief against the automobile. (And, of course, I staunchly agree with some of these points.) Many of the argumentative missiles launched at the automobile become more fully intelligible if one understands them as motivated at least as much by a disinclination to tolerate individual autonomy as by any particular facet of automobile technology.

Consider an example. If the critics love anything less than cars, it is the roads they are driven on. If existing highways are too congested to support the quantity of traffic that squeezes along them, would it not be desirable to build more roads to relieve that gridlock? No! respond the critics. They oppose the construction of more highways on the grounds that as soon as a spanking new road opens to divert some of the flow from overused arteries, it too becomes engorged with traffic. The ultimate consequence is yet another venue for tedious stop-and-go automotive crawling. Better, then, not to waste any more dollars on futile freeway building. And at this point the subject usually turns to mass-transportation subsidies and new imposts on automobiles.

Most readers, I am sure, have heard the argument. But consider how odd it would sound in another context. I am in the business of teaching

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philosophy classes. Suppose that my class in the moral philosophy of Immanuel Kant were very popular, with every seat filled and a waiting list for admission. (Alas, the supposition is counterfactual.) And suppose further that when the philosophy department opens a new section of the class, it too becomes quickly oversubscribed. And the same for a third and then a fourth section. Should we conclude that continuing to pump resources into Kant pedagogy is futile, that instead we ought to use the money for a Nautilus machine in the football training room? That conclusion would be preposterous. Instead, my colleagues and I would rejoice in a renaissance of philosophy in northwestern Ohio.

No renaissance of Kant instruction is occurring, at least not yet. But for other items, one can observe such overflowing demand. McDonald's enjoys success at selling hamburgers. The company has thousands of establishments, many of them filled at rush hour with lines of people in pursuit of Big Macs and Chicken McNuggets. When McDonald's opens a new franchise, it too soon becomes congested with consumers waiting in lines to place their orders. Should we conclude that investing resources in more Golden Arches is futile?

No matter how many millions of instructions per second microprocessors perform, people keep demanding more and faster CPUs. Intel gives them the new generation top-of-the-line chip, and almost immediately people start impatiently clamoring for its successor. Should we conclude from this observed insatiability that investing in computing power wastes resources?

Big Macs and Pentium processors improve people's lives. Similarly, millions of people demand the use of highways because driving enhances their well-being. The striking feature of the critique of highway-building programs is that what should be taken as a sign of great, indeed overwhelming, success is presented as a mark of failure. But the only failure has been the critics' attempt to talk people out of their cars and out of the neighborhoods and workplaces their cars have rendered accessible. If my argument is sound, it shows that the critics' persuasive appeals deserved to fail. Automobile motoring is a good because people wish to engage in it, and they wish to engage in it because it is inherently good.

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Curb Rights

Eliciting Competition and Entrepreneurship in Urban Transit

DANIEL B. KLEIN, ADRIAN T. MOORE, AND BINYAM REJA

Urban transit in the United States has long been dominated by government ownership and regulation, and has been declining steadily in ridership and productivity (APTA 1995). An economist-cum-policymaker would seek to inject competition and entrepreneurship into the sector by privatizing it. The two types of privatization often advocated are contracting out and "free competition" (Department of Transportation 1984; Lave 1985; Gomez-Ibanez and Meyer 1993). Experience has shown, however, that each approach has serious shortcomings.

Contracting out allows government officials to set routes, fares, and the types of vehicles to be used, while putting production and operations in the hands of cost-conscious private companies. Small cities and counties have increasingly contracted out bus service. Larger transit agencies have a harder time establishing major contracting programs, in part because of privileges granted to transit unions. Contracting has reduced costs significantly (Teal 1988, 218ff; Perry, Babitsky, and Gregersen 1988, 134ff), but

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contracts, even when competitively let, preserve transit monopoly and service regimentation. Transit agencies use various contracting schemes, which Williamson (1976) and Goldberg (1976) have criticized because the methods tend in practice to resemble regulated monopoly.

The second proposal, "free competition," promises on-the-road competition, perhaps in the form of freewheeling jitneys, which are small vehicles that pick up and drop off passengers along a route but do not necessarily follow a schedule. The deregulation or "free competition" precept is incomplete, however, when applied to a service that operates on government property, namely, the roadway, curbspace, and sidewalk areas where passengers congregate in waiting. Bus operators must invest in cultivating passenger congregations and must be able to appropriate the returns on their investment. Depending on how "free competition" is governed, it might give rise to parasitic interloping on routes, where jitneys run ahead of scheduled buses to pick up waiting passengers. Such interloping might undermine any scheduled service and inhibit the development of transit markets. All this activity takes place on public property where market mechanisms are lacking.

Calls to merely privatize the buses and to deregulate bus operations have neglected crucial issues rooted in the management and utilization of the public domain. They ignore curbspaces as a fundamental resource of the industry. In fact, the rules—property rights—governing passenger pickup areas are a determining feature of transit markets. Variations in curb rights explain the differences in transit markets seen in the United States and elsewhere. An appreciation of curb-rights issues leads to a better understanding of transit markets.

We proceed by first examining four case studies of transit markets with deficient property rights: the jitney episode in the United States, 1914 to 1916; jitneys and route associations in less-developed countries (LDCs); illegal jitneys in New York City; and the British experience of bus privatization and deregulation. These case studies help us to develop a logic of transit operations and to formulate a theory of transit markets. Finally, we propose a system of "curb rights" that promises to improve transit markets.

Transit Markets with Deficient Property Rights

The U.S. Jitney Episode of 1914 to 1916

When the automobile came on the scene, so did freewheeling competition in urban transit. Jitneys charging a nickel per ride picked up waiting passengers along the routes of the electric streetcars. The jitneys were usually just the sedans of the day, serving as shared-ride taxicabs along loosely defined

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routes. They quickly became popular because of their flexibility and speed—almost twice that of the streetcars. They were more comfortable and less crowded, and sometimes they would deviate from the main route to make courtesy drop-offs. By 1915 jitneys operated in most major cities and reportedly numbered 62,000 nationally (Eckert and Hilton 1972, 295–96; Saltzman and Solomon 1973, 63).

Streetcar companies immediately reported losses due to jitney competition, and many began laying off employees and cutting service. But jitneys did not just interlope on streetcar routes; they also filled important market niches. For the most part jitneys made short trips and provided transportation to many people who otherwise would not have been served by the streetcars. Although jitneys charged no more than the streetcars, their gross revenues far exceeded the streetcars' loss of revenue (Eckert and Hilton 1972, 296; Rosenbloom 1972, 5).

The jitneys were loosely organized and highly spontaneous. Most jitney drivers were independent, some between jobs or working part-time to supplement their income. Many were simply working people who picked up fares on the way to their regular job. Others were teenagers who borrowed their parents' car to earn money after school (Eckert and Hilton 1972, 294). Jitneys adapted flexibly as demand changed with the weather, time of day, day of the week, special events, and so on. Despite the decentralized nature of jitney transport, there emerged customs, voluntary associations, and company fleets. The associations helped drivers obtain insurance and share maintenance services and protected the drivers from hostile lawmaking; sometimes the associations coordinated routes and schedules for their members (Eckert and Hilton 1972, 295–97).

The electric streetcar companies saw the jitneys as an infringement on their exclusive franchises and lobbied the government to regulate the jitneys. The municipalities went along with streetcar demands, in part because the streetcars afforded them tax revenue and free movement of police and fire department personnel (Hilton 1985, 37). Municipalities required jitney drivers to obtain substantial liability bonds and operating permits. These measures and other antijitney ordinances proved fatal. The jitneys had largely disappeared by 1917, after just two years of rapid growth and experimentation.

The jitney situation posed a fundamental question of property rights: Is interloping on scheduled service a form of theft or a form of legitimate competition? The authorities decided it was theft, plain and simple, and instead of developing a framework that could accommodate competitive coexistence, they stamped out freewheeling transit in favor of large-scale monopoly.

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Jitneys and Route Associations in the Less-Developed Countries

Transit services similar to the U.S. jitneys of 1915 still operate on the streets of hundreds of cities throughout the less-developed world. Takyi (1990) describes the jitney's appeal to riders:

> They charge relatively low fares and provide wide coverage across a city, often serving poor areas that get no other service. Their operations are flexible so they can add service at peak times and quickly cover new neighborhoods. Their small size and cheap labor enables them to profitably provide frequent service in smaller neighborhoods and along narrow streets, as well as work the main thoroughfares. With fewer passengers, they often make fewer stops and faster time. (171)

The American jitneys of 1915 had these advantages until regulations blunted their competitive edge. In the LDCs, laws have been passed to prevent jitneys from interloping on official service and from establishing competing routes, but the enforcement is lax, and, as Takyi (1990) says, the jitneys "never operate legally" (175). Takyi tells of "the loss of passengers at transit stops to jitneys during lean as well as peak periods."

As jitney service develops in thick transit markets, various curbside conflicts and confusions start to occur. Any operator who attempts to establish scheduled service will face interloping. Some operators will run ahead of the scheduled service; others will linger at the curb to fill up, disrupting traffic and taking ridership from the arriving vehicle (Roth and Shephard 1984, 4; Diandas and Roth 1995, 27–28; Takyi 1990, 167, 175). Consumers may be reasonably well served, but discoordination and lack of trust are often severe (Grava 1980, 285).

Often the jitney operators form a route association, an informal organization to bring order and regularity to service by means of extralegal norms and explicit rules. The jitney literature suggests that route associations have in large measure governed transit services in Lima (De Soto 1989), Hong Kong, Istanbul, Buenos Aires, Manila, Calcutta, and Caracas (Roth and Shephard 1984; Takyi 1990). The route association becomes a regulatory body, similar to government but more local and entrepreneurial. The association lays down rules against interloping and deviating from schedules. It also fixes fares on the route, which may vary with time of day. Associations create enough order to control destructive conflict, but they also operate as cartels. Roth and Shephard (1984, 42), De Soto (1989, 99), Grava (1980, 282), and Cervero (1997, 130, 142) report that associations limit entry.

Thus we arrive again at the issue of rights to waiting passengers—curb

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rights. Jitneys initially transgressed the curb rights of the official bus operators, yet eventually organized to establish curb rights for themselves. How, then, do they prevent new interlopers from transgressing their rights? Mainly, it seems, by employing physical intimidation and strong-arm tactics. Roth (1987) notes that "the methods used by route associations to protect their territory can become criminal, unlawful, perhaps even homicidal" (224–25). Sigurd Grava (1980) describes route enforcement by means "considerably beyond the law" by "district strongmen,...local bosses, criminal gangs, powerful families, brotherhoods of operators or otherwise legal associations" (282). As is common in black markets everywhere, outlaw entrepreneurs employ violence to maintain their territory. De Soto (1989) tells of route associations in Lima appointing "dispatchers" to monitor compliance with rules, and bribing the police to accost and harass "pirates" trying to invade their route (102).

Once route associations have organized their operations, they often seek official recognition. By lobbying, bribery, petition gathering, and other means, the route associations often acquire official status, receiving permits or licenses. Along with official recognition, however, come political obligations and regulations. Transit history in Colombo (Diandas and Roth 1995) and Lima (De Soto 1989) shows a cycle of transit governance: once the decentralized private operators gain official recognition, they are hamstrung by regulation and suffer invasion by a new generation of interlopers. Without curb rights, established officially or otherwise, orderly scheduled fixed-route service does not last.

Illegal Jitney Vans in New York City

Black-market jitneying is not restricted to the LCDs. In New York City and Miami, jitney vans have operated extensively, interloping at public bus stops and establishing routes of their own. People who ride the illegal vans give a number of reasons for preferring them to the city buses.[1] By far the most often mentioned reason is that the jitneys are faster and even cheaper than the city buses. Jitneys also provide a more comfortable ride, with no standing, and many riders enjoy having a driver who speaks their native language. Finally, many riders say that the jitney is safer than the public bus. Because jitneys come more often, riders do not have to wait as long at the bus stop, where one runs a risk of being mugged (Levine and Wachs 1986). Also, jitney drivers will not pick up passengers who are drunk and disorderly or who otherwise bother or threaten the other passengers. Jitney riders, who are

1. This paragraph is drawn from news reports about jitney riders. See Bonapace (1993), Fried (1994), Garvin (1992), Machalaba (1991), and Onishi (1994).

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mostly members of minority groups, appreciate being able to escape the forced association with all comers that a public bus entails.

Extreme cases of interloping jitneys may develop where market conditions are favorable and enforcement efforts not yet mobilized. To persist once enforcement begins, interloping must expand to a point at which individual illegal operators find safety in numbers, as rioters do. Such jitney outbreaks either continue as a significant force or disappear. In most U.S. cities, either market conditions have not favored illegal jitneys or enforcement has been effective.[2] A notable instance of such a jitney outbreak has occurred in New York City. (On Miami's jitneys, see Klein, Moore, and Reja 1997.)

The transit strike in 1980 prompted modern jitney operation in New York City. Illegal jitneys emerged to provide local service and feeder service to the Long Island Rail Road station in Jamaica (southeast Queens). As Boyle (1993) explains, "the jitneys thrived along busy bus routes...because of the high numbers of people congregated at the bus stops along these routes" (3). Boyle reasons that jitney service has developed especially in neighborhoods of Caribbean immigrants because those riders had become accustomed to relying on jitneys in their native lands. After the strike ended and regular bus service resumed, enforcement against the jitneys was only "sporadic" (Boyle 1993, 3). Jitneys had reached the "takeoff" point to self-sustained operation. The authorities now face the dilemma of cracking down on services that are well regarded by paying customers and treated sympathetically by reporters and news commentators.

To operate legally, the vans would have to obtain special permits and a special insurance policy and undergo multiple inspections each year, and the driver would need a special license. The vans could then pick up and discharge passengers only by prearranged appointment; of course, they could not use city bus stops. It is estimated that between 2,500 and 5,000 vans flout these laws (Boyle 1993, 4).

A public transit executive claimed that each year the jitney vans were diverting $30 million of revenue from public transit (Machalaba 1991). Transit police have been assigned to areas near bus stops to crack down on the interlopers. The *New York Times* reports: "In the 18 months ended December 1991, a special task force issued 6,542 civil notices of violation against the vans and 11,773 criminal summonses,...[and made] 251 arrests" (Mitchell 1992). Still, the vans are thought to be uncontrollable. A police officer remarks that two or three vans sail by for every one he tickets, and van drivers pay small regard to the summonses. The *Wall Street Journal*

2. Boyle (1993) states: "Transit and planning personnel in Chicago, Los Angeles, Atlanta, and Houston indicate that jitneys were not operating in any extensive or arranged fashion in their cities" (1).

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(Machalaba 1991) reports that over a one-year period the van drivers have been assessed fines of more than $4 million, but the city collected only $150,000. Fear of racial flare-ups dampens the will to go beyond current enforcement measures, which amount to random delays and hassles for the drivers and their patrons.

The New York jitney experience shows again that unsubsidized private enterprise can supply fixed-route transit, even when having to cope with enforcement efforts against the jitneys. We see also that the property right to waiting bus passengers, as well as the degree of enforcement, is a fundamental component in such operations.

Bus Privatization and Deregulation in Britain

The 1985 Transit Act deregulated the British bus industry everywhere except London.[3] (In London competition is required only as competitive contracting; there is no on-the-road competition.) All publicly owned bus companies were reorganized as private corporations. The law requires operators to register the commencement of, or changes to, bus service at least forty-two days in advance. The only grounds for local government to refuse to allow a service are serious safety or traffic congestion problems. Local authorities can supplement privately registered routes by putting unserved routes out for competitive tender.

Deregulation permits only scheduled services, not unscheduled services such as jitneys. This restriction, along with the strength of law enforcement in Britain, precludes freewheeling jitney activity and the sort of interloping seen in the less-developed countries.

On-the-road competition was initially strong, but has tapered off to a rather low level (Dodgson 1991, 125; Hibbs 1993, 52). However, one must also consider the question of contestability, or the ability of potential entry to disciplined incumbent firms. Mackie, Preston, and Nash (1995, 232) and Dodgson and Katsoulacos (1991, 265–66) suggest that contestability is constrained by the sunk costs of establishing a scheduled service and by the "economies of experience" held by incumbent operators. Another constraint of contestability, which they do not mention, is the ability of an incumbent firm to react quickly to a competitive challenge. Contestability theory suggests that if an incumbent firm can quickly and easily reduce its fares when a competitor challenges it, would-be entrants might be reluctant to enter, even in a market with high fares (Bailey 1981; Bailey and Friedlander 1982). The challenger can no longer expect to grab market share by offering a

3. Gomez-Ibanez and Meyer (1990), Bannister and Pickup (1990), and White (1995) provide summaries of the 1985 Transport Act.

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lower price, and the incumbent has the advantage of experience, reputation and, in most cases, size.

In fact, British firms have rarely competed by offering lower fares (Dodgson and Katsoulacos 1991, 271–72). Real bus fares increased 17 percent between 1987 and 1994 (White 1995, 198). Instead of competing by offering lower fares, firms chose to offer more frequent service than their competitors. Free competition does not necessarily generate price cutting, as has also been found in deregulated taxi markets (Frankena and Paulter 1986; Teal and Berglund 1987). It seems that information and coordination problems between drivers and potential riders may push transit markets toward a single, or focal, fare rate.

Under the British reforms, registering a scheduled service does not secure one a right to the congregating passengers at the curb. One bus operator can interlope, in a manner of speaking, by registering his own *scheduled* service, to be provided just minutes before the scheduled service of another. As the law does not proscribe schedule matching, local authorities must allow it. Many British bus operators adopt this strategy, which we call "schedule jockeying" (Dodgson 1991, 126; Dodgson and Katsoulacos 1991, 269; Savage 1993, 146; Gomez-Ibanez and Meyer 1990, 13). Because the established firm has no period secure from schedules of competitors, congregations of passengers waiting at the curb can be snatched up by competitors offering comparable fares. Waiting time so dominates passengers' travel decisions that any reputation and amenity advantages an incumbent may offer are not likely to keep waiting travelers from taking the first bus to arrive (Weisman 1981; Wachs 1992; Dobson and Nicolaidis 1974).

Incumbent bus companies, however, quickly learned to monitor the registration of new services by competitors using this strategy, and often respond promptly in kind. The forty-two-day registration period makes it easy for firms to monitor each other's changes in service and to respond in a potentially endless regress. In the face of a mutually destructive battle, the incumbent has often responded simply by scheduling service so frequently that the challenger cannot expect to get enough riders to survive. The practice, known as "route swamping," has been very common (Dodgson 1991, 126; Dodgson and Katsoulacos 1991, 269; Savage 1993, 146; Gomez-Ibanez and Meyer 1990, 13). The technique has a strategic effect in the immediate contest and in signaling the willingness to use route swamping against future challengers. The ability of incumbent firms to quickly and easily change their schedules in reaction to entry, by virtue of the forty-two-day registration period, constrains contestability in the same way that easily and quickly adjustable prices do in standard contestability theory.

Large incumbent firms often conclude a route-swamping conflict by buying out small rival firms. Also common are mergers between firms that

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do not compete directly against each other (Mackie, Preston, and Nash 1995, 235; Savage 1993, 147). Many of the latter mergers have taken the form of holding companies, with their subsidiaries often geographically dispersed (Gomez-Ibanez and Meyer 1990, 12–13). The result has been a clear trend toward oligopolistic and even monopolistic operations in the industry, another important unexpected outcome of deregulation (Banister and Pickup 1990, 81; Savage 1993, 147). In many counties just a few firms control over 80 percent of the market (Banister and Pickup 1990, 81). Small operators have been progressively squeezed out of the competitive market, while finding more success in the tendered contract market.

The literature offers numerous explanations for the concentration of the industry. Hibbs (1991, 4) suggests economies of scope and management efficiencies. Mackie, Preston, and Nash (1995, 235–36) and White (1995, 202–3) point to financial advantages of larger firms, managerial economies of scale, and bargaining power. Gomez-Ibanez and Meyer (1990, 12–13) argue that holding companies offer many advantages, including very low costs and the ability to move vehicles and managers from subsidiary to subsidiary as market conditions dictate. They add that firms with large networks have a distinct advantage in the growing use of single-rate, unlimited-travel fare cards. Nash (1988, 110) indicates that larger firms enjoy considerable economies of scope in scheduling buses and avoiding long layovers between runs. Finally, Dodgson and Katsoulacos (1991, 267) point out that to some extent the managers of formerly public firms may have retained their old habit of output maximization despite its inappropriateness for achieving the new goal of profit maximization. The issue of integration might suggest yet another explanation. Dodgson (1991, 124) and Nash (1988) note a steady decline in interoperator ticket availability. White (1992, 56) mentions one case in which the removal of schedule coordination and interoperator ticketing led to a 20 percent reduction in ridership. If firms really cannot negotiate interoperator ticket agreements, and thereby lose ridership, they have an incentive to expand their network to minimize inconvenience to riders.[4]

Although many of these theories have merit, curb rights are fundamental to the peculiar form of deregulation in Britain. Recognizing that the ability to swamp a route is necessary to combat schedule jockeying, one understands the advantages of larger firms with broader networks. As Gomez-Ibanez and Meyer (1990, 13) point out, a larger company has more supervisors, drivers, and buses at its disposal, which it can shift about to swamp a route where a competitor has commenced schedule jockeying. A larger firm

4. Indeed, many trips using more than one carrier are more expensive than a trip of the same length on one carrier. Hibbs (1991, 5) argues, however, that only a small number of trips involve a change of carrier.

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will also have greater financial flexibility to maintain such "fighting fleets" (Dodgson and Katsoulacos 1991, 267, 270). Indeed, the very largeness of the firm presents a formidable warning, signaling potential entrants that entry can and will be met by swamping. Although British deregulation of buses has led to large reductions in costs and public subsidization (White 1995, 194; Mackie, Preston, and Nash 1995, 238; White 1992, 50), it has also yielded a surprising degree of industry concentration, with lackluster competition. Our theory of schedule jockeying and route swamping, rooted in an appreciation of curb rights, helps to explain these developments.

A Theory of Transit Services

The Market Advantages of Jitneys

The American experience from 1914 to 1916 and that of transit markets in some less-developed countries today suggest jitneys have market advantages over scheduled bus service on both the supply side and the demand side. Because jitney operators follow a route but not necessarily a schedule, they enjoy efficiencies in flexibility with respect to their schedules and to changes in weather, congestion, time of day, day of week, and so on. They enjoy flexibility in responding to traffic conditions and can make small deviations from the route. Under a free-entry policy for jitneys, one could expect a cascade of irregular, short-term participants on heavily traveled routes.

On the demand side, passengers waiting for a scheduled bus are generally quite happy to ride a jitney that charges a comparable fare and goes to the same destination. The jitney running ahead offers several advantages. It is available "now," whereas the bus is yet to arrive. It is smaller and faster; its driver is perhaps more courteous; and it may offer deviations from its route, perhaps at an extra charge. The bus is cumbersome and dreary; the jitney is entrepreneurial, more personalized, and even somewhat charming (Takyi 1990, 165). Still, patrons may prefer to wait for the scheduled bus because it offers more certainty and trustworthiness and perhaps because it is more comfortable than the jitney (Grava 1980, 285). In what follows, we posit that passengers generally prefer to ride in the preceding jitney that charges the same fare as the scheduled service.·

Appropriability of the Returns on Investment in Scheduled Service

If, in the presence of scheduled service, jitneys enjoy inherent market advantages, the fate of scheduled service hinges on whether jitneys have free run of the streets. The specification and enforcement of curb rights determine whether jitneying will flourish. In the experience of America in 1915, of ille-

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gal jitneys in America today, and of jitneying in some LDC cities, scheduled services do not enjoy fully established and exclusive curb rights, either because jitneying is legally permitted or because prohibitions are not enforced.

Where interloping is both prohibited and effectively controlled, bus companies will invest in establishing routes and schedules, publicizing the information, and running the service in an incipient market because they can appropriate the value of these efforts to bring people out to the curb. Although transportation economists have identified no economies of scale in merely expanding bus service (Viton 1981; Shipe 1992; Hensher 1988), they have neglected the appropriability of the returns on investment in setting up and cultivating a route. But firms make specific investments in cultivating a route and schedule, and the appropriability of returns on this investment depends on curb rights. We assume that because jitneys enjoy inherent market advantages, if they are free to interlope they will dissolve any scheduled service. Without the "anchor" of scheduled service, however, fewer riders congregate at the curb and thus fewer jitneys ply the route.

Thick and Thin Transit Markets in the Absence of Curb Rights

Another distinction of fundamental importance is whether ridership on the transit route is potentially heavy enough to sustain the cascade of jitneys in the absence of scheduled service. If the market is potentially thick, a situation may develop in which there is no scheduled service yet jitneys ply the route spontaneously because they have confidence in finding passengers, and passengers congregate at the curb because they have confidence in finding jitneys plying the route. The emergence of conventions that coordinate vehicle services and congregating passengers occurs in America today in the cases of some commuter shuttle vans and carpooling practices (Walder 1985; Cervero 1997, 97).

In an inherently thin market this outcome, even if it occurs, cannot be sustained: there will not be enough passengers for jitney service to be frequent, so waiting times for unscheduled service will be too long to induce passengers to congregate. Because the coordination problem of unscheduled service is severe in thin markets, service might disappear altogether.

The Thick Market: The Jitney Cascade Is Sustained

Consider the case of the potentially thick market with no exclusive curb rights and thus no scheduled service. The horizontal axis of figure 1 counts the number of jitneys per hour that ply the route. The vertical axis counts the number of passengers who congregate at the curb per hour. The thick line shows the number of jitneys that would come out to serve the route,

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given the number of congregating passengers. This jitneying function shows that no jitneys serve the route when there are no congregating passengers. Once congregation passes a minimal amount, jitneys begin to offer service. In the figure the jitneying response is shown as linear, but it might plausibly be shown as rising at a declining rate because of congestion among jitneys. The thin curve shows the number of people who would congregate at the curb, given the number of jitneys serving the route. It starts at zero, then rises at an increasing rate, but because only so many people have any demand at all for jitney service the curve eventually flattens out.

The curves show the mutual dependence of the two sides of the market. If only sixty people congregate per hour over the course of a week, about 6.7 jitneys an hour will respond. The next week, people expect about 6.7 jitneys an hour, and therefore only about fifty people will congregate. The next week, jitney operators expect only fifty people per hour, and the jitney function shows that therefore the jitneys come out in even smaller numbers, and so on. For a point to the lower left of point Y, the system degenerates to no market at all, point Z. At point Z, a stable equilibrium, it would make no sense for any jitneys to ply the route or for anyone to wait for a jitney.

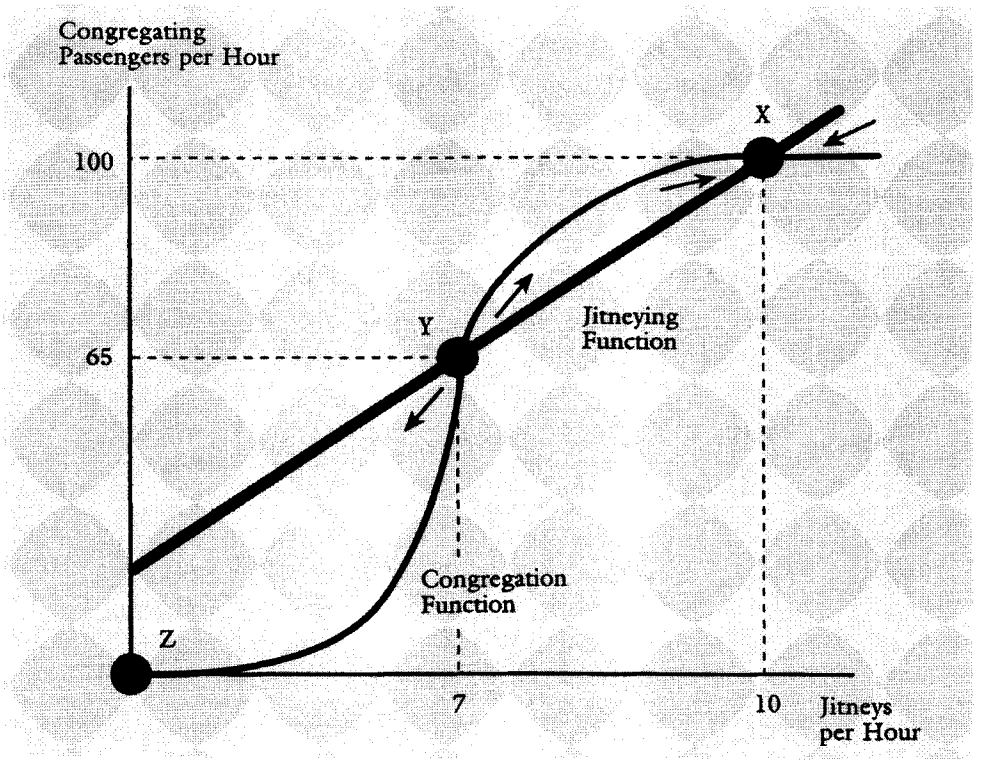

Figure 1. Interactions between Congregating Passengers and Cruising Jitneys in a Potentially Thick Market

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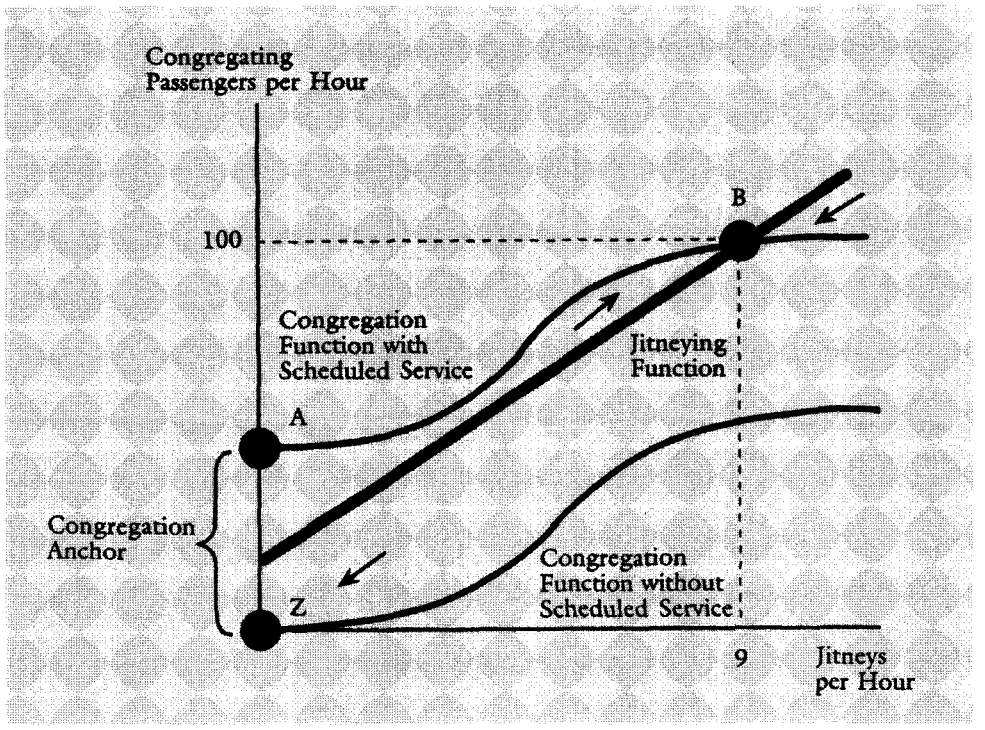

Figure 2. Interloping Jitneys Dissolve the Scheduled Service and Destroy the Market

Suppose that a critical mass were to develop beyond point Y, perhaps due to a transit strike, a coordinated effort by jitney operators, or an unusual event such as the Olympics or a hurricane. In that case the system would maintain its life. If, for example, eight jitneys per hour were to ply the route, that would induce significant congregations, which would induce even more jitneys, and the system would bounce up to the other stable equilibrium at point X. Ten jitneys per hour induce exactly 100 congregating passengers, and 100 congregating passengers induce exactly ten jitneys. This condition is the realization of potential in a thick market.

The Thin Market: The Dissolving Anchor

Figure 2 illustrates the thin market but also posits that the market begins with scheduled bus service. This is the case of the "dissolving anchor." The scheduled service begins to operate and builds up a market. At first no jitneys participate, perhaps because jitney operators have not seen an opportunity before the development of this market or because they have not tested the powers of enforcement against interloping. With scheduled service and no jitneys, the number of passengers corresponding to point A wait

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for the bus. This passenger congregation is the "anchor" provided by scheduled service. Assume that for some reason jitneying suddenly becomes possible, perhaps because operators come to recognize that enforcement against interloping is weak or nonexistent. They begin to run ahead of the scheduled service, and many passengers are willing to take whichever vehicle comes first. The relationship between the upper congregation function (with scheduled service) and the jitneying function implies that the system will be driven to point B, where nine jitneys ply the route and 100 passengers wait for service. Passengers and jitneys like this outcome, but because the scheduled bus is now not getting enough riders, it pulls out. The anchor dissolves. Now passengers are less enthusiastic about congregating at curbside, for two reasons. First, they do not have the guarantee of anchor service, so they may have to wait longer or with more uncertainty for a carrier. Second, without scheduled service, there is no longer a focal schedule for arrival times at the stops. Jitney arrival times become less predictable. Hence, when people go to the curb they go with less certainty of when a jitney will arrive, and they wait longer at the curb.[5] The decrease in passenger enthusiasm is shown by the shift downward of the congregation function. Nine jitneys per hour now attract fewer passengers. This reduction in turn reduces the number of jitneys, which in turn reduces the number of passengers, and so on. Finally the system settles at point Z, for zilch. Thus, the progression is as follows: we begin at point A with scheduled service; jitneys come to interlope and the system moves to point B; the anchor is dissolved; and then the system moves to point Z, or market disintegration. In a thin market the jitney cascade cannot be sustained.

A Typology of Route-Based Transit Markets

In figure 3 we suggest a typology of fixed-route urban transit. The top-left cell represents unsubsidized buses with exclusive monopolies on routes with moderate to thin patronage. Exclusive rights are established; there is no interloping and no competition. Therefore the scheduled service is preserved. But potential problems include inadequate competition and inert monopoly: the incumbent knows that entry is unlikely and consequently skimps on service or increases fares. Moreover, potential operators will waste resources seeking the "rent" associated with the monopoly privilege (Tullock 1967).

5. It might be thought that once the scheduled service pulls out, the jitneying function would shift outward, because jitneys pick up passengers who had been taking scheduled service. This shift may not occur, however, because passengers are now more randomly dispersed over the course of the hour due to the loss of schedule focus.

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	Exclusive Route for the Scheduled Service Provider	No Exclusive Rights for Scheduled Service	No Exclusive Rights *and* Scheduled Service is Subsidized (and Charges Low Fares)
Thin Market	**Scheduled Service Preserved** *Possible Problems:* inadequate competition, inert monopoly	**Interlopers Dissolve Any Anchor** *Possible Problems*: market destroyed	**Scheduled Service Monopolizes Market** *Possible Problems:* franchising problems, subsidy inefficiencies, political conflict, limited discovery, limited flexibility
Thick Market (Potentially)	**Scheduled Service Preserved** *Possible Problems:* inadequate competition, inert monopoly	**Interlopers Dissolve Scheduled Service, But a Cascade of Jitneys Offers Low-Cost, Unscheduled Service** *Possible Problems:* low quality, irregularity, unreliability, untrustworthiness	**Scheduled Services Preserved, but Jitneys May Serve Excess Demand** *Possible Problems:* franchising problems, subsidy inefficiencies, political conflict.

Figure 3. A Typology of Fixed-Route Urban Transit

In the bottom-left cell the story is not much different. Again, scheduled service is preserved because interloping is not tolerated. Because the market is thick, it would be better able to support multiple scheduled services, more frequent service, and more consumer choice, but still competition is not tolerated. The problem of inert monopoly is more severe.

The middle cells present conditions without exclusive rights, because they are not granted or not enforced. The entire route is essentially a pure commons. With no impediment to running ahead or interloping, in a thin transit market, shown in the top middle cell, interlopers will run ahead on any scheduled service and collect the waiting passengers. This is the case of the dissolving anchor. The lack of property rights in the waiting passengers results in the "tragedy of the commons" (Hardin 1968). The entire market may be destroyed, for once the anchor has dissolved, people no longer wait and jitneys no longer ply the route.

The case of the thick market is shown in the bottom-middle cell. Here the lack of curb rights may not be a serious problem. Indeed, any scheduled service will be dissolved, but in a thick market scheduled service does not

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necessarily function as an "anchor." Combining elements of figures 1 and 2, visualize the lower congregation function (without scheduled service) in figure 2 as intersecting the jitneying function as does the congregation function in figure 1. The market is thick enough to sustain the cascade of jitneys, and riders will be satisfied by flexible, low-cost, and frequent service. This outcome has sometimes occurred: in the American jitney experience of 1915, a few markets in America today (both illegal and legal), and many of the LDC transit markets. In any place, however, possible problems with the jitney cascade outcome include low quality, irregularity of service, high uncertainty of terms, and lack of trust.

A case that does *not* fit into the typology but which would go between the first and second columns can be imagined. In the British deregulation experience, bus operators enjoy neither exclusive monopolies (column 1) nor operate on a pure commons (column 2). Rather, free competition is permitted among providers who register schedules in advance. The situation is not that of the pure commons because freewheeling is not permitted. The British example suggests that nuanced approaches can be fashioned to fit between the two extremes of exclusive monopoly and pure commons. We will pursue this idea and propose a property-rights framework that avoids monopoly by refining rights along a route.

In the cases considered so far, we have assumed that service providers receive no subsidies. Now consider the case in which scheduled service does receive subsidies (notably government subsidies, but much of the reason-ing applies also to cross-subsidies). Subsidies usually lead to very low fares. When subsidized service is combined with exclusive curb rights, conditions are similar to those described in the first column of figure 3. The scheduled service, because it charges low fares, is now even more immune to interloping, so again it is preserved. Inadequate competition and the familiar problems attendant to government subsidization characterize this case.

The third column of figure 3 depicts the results of subsidized, low-fare service without exclusive curb rights. Interlopers are free to run ahead of the scheduled service, but doing so would be futile because patrons decide they will wait for the scheduled bus, which offers a lower fare. For example, in Los Angeles in 1983 private jitneys were allowed to operate on thirty public transit routes. Matching the eighty-five-cent public bus fare, they succeeded initially, but they promptly withdrew when the city lowered bus fares to fifty cents (Teal and Nemer 1986).

In a thick market, shown in the bottom-right cell, the low fares of the scheduled service again will attract riders, but demand might exceed supply. One of the present authors has witnessed transit operations in Shanghai, where low-fare buses are packed sardine-style and jitneys and taxis cater to

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the excess demand. In this case, jitneys survive because of excess demand and because they offer superior quality (less crowding, speedier service), even though they charge higher fares. Further, jitneys charge according to trip distance, so someone traveling a short distance might find the jitney fare more appealing than the undifferentiated bus fare.

Now, imagine a decision to privatize and deregulate. If public transit subsidies are eliminated, only the first two columns of figure 3 remain. These two options represent the horns of a dilemma. In one case a provider of scheduled service has an exclusive monopoly over the entire route. Without competition, the provider has little incentive for service improvement and innovation, and fares will be higher. In the other case, no exclusive rights exist. The anchor of scheduled service would be dissolved by jitneys, and markets may never emerge. If policymakers are confined to choosing between these two horns, they should choose on the basis of whether the market is thin or thick. If the market is thin, they should choose monopoly because the alternative results in no service at all. If the market is potentially thick, they should choose not to grant exclusive rights to the route and simply allow the jitney cascade to burgeon. This option will bring freewheeling service and competitive energy to the market, whereas the alternative would be inert monopoly.

Even better, however, would be an option that avoids both horns of the dilemma, one with limited exclusive rights, to prevent the anchor from dissolving, and with freewheeling competition on the route.

Governance for Bus and Jitney Services: Curb Rights

The answer lies in a system of curb rights that both guarantees some exclusivity to those who successfully cultivate passenger congregations ***and*** fosters the jitney cascade. No specific system of curb rights is necessarily best for all transit conditions. Because each case is unique, local officials ought to use their knowledge of local conditions to create a suitable curb-rights system.[6]

6. The hope that local government officials will carry out this task diligently, honestly, and competently must take heed of public choice considerations. But the realm of hope is one of relatives, not absolutes. The public choice pitfalls of government action do not undermine the merit of our proposal when it is viewed in comparison to the status quo or other schemes for government management, because in those other arrangements the same public choice pitfalls apply with equal or greater force. The curb-rights proposal does suffer from public choice pitfalls in comparison to full privatization of not only curb zones and bus stops but the entire system of streets and sidewalks. On the viability of such a plan, see Klein (1997).

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Spatial Demarcation of Curb Rights

A simple case would combine a scheduled service provider with the jitney cascade. Figure 4 is a schematic diagram showing curb rights demarcated in space and time. Consider first just the spatial component, where exclusionary zones are separated by a distance. The 8:00 column shows four curb zones. When we speak of "curb zones" or "curb rights," it should be understood that we mean not only the curb but also the adjoining space on the sidewalk and road—in other words, a complete bus stop. The column shows how Company A is granted two exclusionary curb zones where no other operators may pick up passengers. Think of each exclusionary zone as being 200 feet in length, with the bus stop situated at the midpoint. Company A has an incentive to invest in creating passenger congregations at its bus stops. It would establish a route and schedule and be free from interloping. Yet along the same route jitneys meeting minimal safety and insurance requirements would operate, picking up passengers at nonexclusive zones, or commons. At the commons, passengers have an alternative to Company A, because others (including Company A) may stop and offer service.

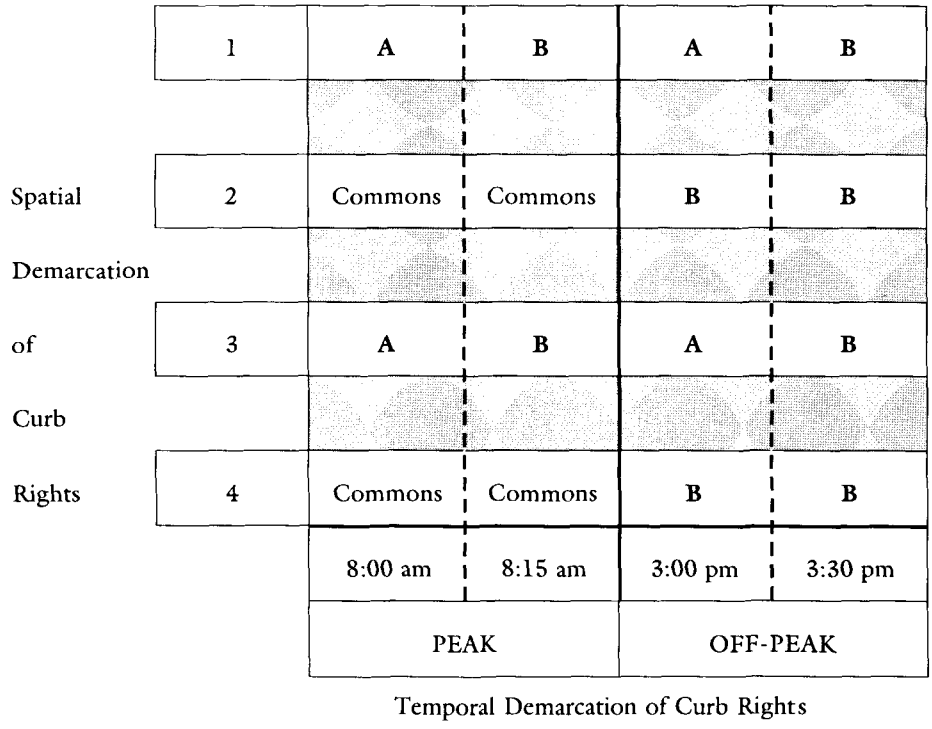

Figure 4. Property-Rights Assignment to Curb Zones

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Temporal Demarcation of Curb Rights

Exclusionary zones may also be defined according to time intervals. Consider the two peak-period columns, at 8:00 and 8:15. These illustrate that curb zones may be exclusive for Company A during a fifteen-minute interval and then become the "property" of Company B. This system may make enforcement more difficult, but time-elapsed video evidence could show curb-rights violations. This principle of exclusionary intervals responds to the central failing of the British bus deregulation: the ability of one company to insert its service just ahead of the competitor's, and hence schedule jockeying and route swamping, which disrupt service and diminish competitiveness in the industry.

In a thin market, giving free play to the jitney cascade might dissipate all service. Off-peak periods often present thin markets. The off-peak times in Figure 4 show an arrangement that precludes jitneys but accommodates competition on the route by granting exclusionary zones first to Company A and then to Company B. Instead of temporal alternation, local authorities might deem it better to have spatial alternation of A and B in the same column. Either way, this competitive arrangement would avoid monopoly, unless the two providers were to collude, and would give each provider an incentive to invest in building its ridership. It forgoes, however, the creative and highly efficient input of the freewheelers.

Auctioning Curb Zones

Now, look at figure 4 and in place of the As and Bs envision dollar signs. The authorities could define exclusive curb zones and simply put them up for sale, perhaps in the form of five-year leases. The leases could be sold at a set price or auctioned. Auctioning the curb rights would avoid the hazard of monopoly power arising from a maldistribution of initial rights (Hahn 1984). The curbspace holder could then have its buses make stops in its leased zones. Under this plan, individuals with local advantages and knowledge of local opportunities could negotiate to make the most of the resource, and the one with the highest valuation would get the curbspace. Further possibilities emerge if the curb rights may be sublet or resold, which we think should be permitted. The holder may then wish to authorize other carriers to pick up in its curbspace in exchange for a monthly rental payment. Or it could sell the lease rights to a provider with a higher valuation of the curbspace.

One can imagine the emergence of professional curb-zone entrepreneurs who lease available zones, sublet pickup rights to carriers, stage passengers and carriers, and monitor and police the curb rights. Such lease-

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holders could even sublet to jitney associations, but they would manage this competition to protect their interest in their dealings with scheduled buses. Leaseholders could also profit by using the advertising opportunities on transit benches and shelters (Weisman 1984). Our visualization of a curb-rights system includes at least four categories of participants: local officials, curb-zone leaseholders, transit operators (bus companies, jitneys, and so forth), and passengers.

The scenario of a market in curb rights might raise the specter of holding companies or "robber barons" buying all the curb zones and exercising monopoly power over the route. The local authorities could preclude this outcome, however, in a variety of ways. In a thick market the most powerful method is for them to reserve certain curb zones as jitney commons, giving the jitney cascade a potential to compete with scheduled service. In a thin market with a monopoly problem, the authorities could ensure that competing service providers each have their own curb rights.

Enforcement of Curb Rights

Any curb-rights scheme depends crucially on the enforceability of curb rights. Enforceability may not be feasible, but we have good grounds for optimism. In the United States today, only in very exceptional instances, as in New York City and Miami, are the curb rights of official services transgressed at all. In Britain, where the scheduled service is typically unsubsidized, no interloping occurs. Most Americans are law abiding, and local governments can protect curb rights.

Harold Demsetz (1967) has explained how one's effort to establish and enforce one's own property rights depends on the costs and benefits of doing so. Local authorities ought to take measures to reduce the costs and increase the benefits of enforcing curb rights. The holder of the curb rights should be encouraged to monitor the "property." Violation of the rights should be treated as a private tort as well as a municipal violation. Therefore, in addition to depending on municipal enforcement efforts by traffic or transit police, holders of curb rights could, for instance, set up enclosed video cameras to watch for repeated trespass. The video footage of trespassing jitneys would simplify their identification and apprehension and serve as evidence. Technology and official practice are advancing the photographic enforcement of traffic laws (Turner 1995; Blackburn and Gilbert 1995). Furthermore, the drivers of scheduled vehicles could provide eyewitness accounts of running ahead. Suit could also be brought against riders of trespassing jitneys. The holders of curb rights could put up signs at its bus stops: "Boarding an unauthorized vehicle in this zone is a trespass and sub-

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ject to civil suit." Travelers would find this reasonable because they could simply walk away from the exclusionary zone to wait legally for a jitney. With a sense of curbspace proprietorship and fair competition, both jitney operators and passengers would be likely to respect curb rights.

Emergence of Staging Areas on Private Property

Jitney commons zones are designated in figure 4, but it might not be necessary to preestablish such zones. It might be sufficient to prohibit jitneys from picking up passengers in the A zones, allowing their own curb zones and staging areas to emerge spontaneously. Local officials may wish to manage the emergence of such pickup spots to avoid sidewalk congestion or to provide transit focal points, but if certain places seem to be emerging as workable jitney spots, the officials ought to smile on the development. They may wish to alter parking or standing rules at such spots and perhaps even to provide turnouts, benches, and shelters. Imagine a McDonald's restaurant emerging as a jitneying point, where travelers can buy breakfast and organize shared rides on innovative McTransit (Rehmke 1991). If the McDonald's began to charge for daytime parking or to cooperate in announcing or arranging jitney departures, this activity ought to be regarded as legitimate private enterprise. Throughout the city, entrepreneurs may find it profitable to develop jitney staging areas on private property, and jitney associations may want to negotiate a system of such spots with local businesses. In our scheme, local officials are not primarily regulators; they are creators and enforcers of property rights. Provided that jitney operators and staging entrepreneurs do not tread on the property rights of others, they should be allowed to operate unencumbered.

Conclusion

We have developed a theory of scheduled bus service that recognizes the importance of generating passenger congregations. Furthermore, the returns on investments in cultivating passenger congregations must be appropriable or protected from interloping. Transit markets tend to be gored by one of the two horns of a dilemma. In some markets, scheduled operators can appropriate the value of passenger congregations, but only by means of a grant of exclusive rights not only to the waiting passengers but to the entire route. Thus the first horn is transit monopoly. The other horn is the pure commons, which gives rise to freewheeling competition like that found in some LDC cities. In this case no one cultivates passenger congregations for scheduled service because interlopers will expropriate the investment. In consequence, thin markets receive especially poor service.

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	Exclusive Route for the Scheduled Service Provider	Refined System of Curb Rights for Scheduled Service	No Exclusive Rights for Scheduled Service
Thin Market	**Scheduled Service Preserved** *Possible Problems:* inadequate competition, inert monopoly	**Scheduled Service Preserved; Potential for Competing Scheduled Services; Commons Provides Jitneying Opportunities**	**Interlopers Dissolve Any Anchor** *Possible Problems:* market destroyed
Thick Market (Potentially)	**Scheduled Service Preserved** *Possible Problems:* inadequate competition, inert monopoly	**Scheduled Services Preserved *and* Cascade of Jitneys Offers Low-Cost, Unscheduled Service**	**Interlopers Dissolve Any Scheduled Service, But a Cascade of Jitneys Offers Low-Cost, Unscheduled Service** *Possible Problems:* low quality, irregularity, unreliability, untrustworthiness

Figure 5. A Typology of Unsubsidized Fixed-Route Urban Transit Incorporating Curb Rights

A nuanced approach based on property rights can maneuver between the horns of this dilemma. We can have the best of both cases: scheduled service and freewheeling jitneys. Figure 5 revises figure 3 by inserting our solution between exclusive monopoly and the pure commons (and by eliminating the case of subsidized service).

The type of governance suggested here rests on the creation of exclusive and transferable curb rights, leased by auction. Scheduled service providers would have exclusive protection where their passengers congregate, and jitneys would pick up passengers at curb zones designated as commons. Within the property-rights framework of curb rights, entrepreneurs would be free, able, and driven to introduce ever better service, revise schedules and route structures, establish connections among transit providers, introduce new vehicles, and use new pricing strategies. Once the system of curb rights was sensibly implemented, the market process would operate. One feature of this process is competition; another is the discovery of new opportunities for

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service resulting from entrepreneurial insight into changing local conditions. Within a suitable framework of property rights, the invisible hand will be able to do in urban transit markets what it does so well in other parts of the economy.

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Preventing Banking Crises in the Future

Lessons from Past Mistakes

GEORGE G. KAUFMAN

Almost every country—large or small, developed or developing, free market or planned, free enterprise or socialistic, democratic or authoritarian, western or eastern, northern or southern—has experienced serious banking (depository institution) problems in recent years.[1] Few countries have escaped unscathed. The cost of resolving these problems has been, or will be in most instances, borne primarily by the taxpayers. The cost of resolution to the public is equivalent to the part of the aggregate negative net worth of the banking institutions that is not paid by the financially healthy banks or other private sources. To date, the public's contribution has ranged from a small percentage of the respective nation's GDP, about 2 1/2 percent for the United States, to more than 20 percent in some countries. Not surprisingly, taxpayers have not been overly enthusiastic about paying this amount and have blamed the political party in power, as well as the regulators and the bankers, for their misfortune.

How did so many countries get themselves into such a mess? My analysis of the causes of the banking debacles suggests that a number of causes are common to all countries regardless of their type of banking system or

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1. According to Lindgren, Garcia, and Saal (1996), more than 130 of the 181 IMF member countries have experienced serious banking problems in the past decade or so. See also Garcia and Saal (1996) and Caprio and Klingebiel (1996).

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economic structure. Moreover, the commonality spills over to the strategies initially employed by the governments to solve the problem, albeit with little if any success. Thus, we can learn much from the mistakes of the past.

The most important common mistake made is believing that banking differs significantly from other industries and treating it as special for purposes of public policy. This has resulted in the almost universal adoption of government safety nets under banking, which unfortunately have been so poorly designed for the most part that over time, by contributing to the problem they were intended to solve, they have done more damage than good. Avoidance of similar banking problems in the future requires a better understanding of banking as a business and of the implications of bank failures, as well as a better design of the safety net.

Is Banking Special?

I, along with my frequent coauthor George Benston and others, have recently reexamined whether banks are "special" and, if so, in what ways (Benston and Kaufman 1995). Many observers have long considered banks special both because they are "fragile" and thus likely to break and because they are an integral part of the payments system through providing deposits, which constitute a large part of a country's money supply, and, in some countries, operating the clearing system for checks and electronic funds. The latter functions make them the primary channel through which the central bank transmits monetary policy. Thus, some people fear that large-scale and even individual large institution failures could have major adverse effects on the financial system and possibly beyond to the domestic and even international macroeconomy that would be greater than those created by the failure of other business firms. Bank failures might start a domino or snowball effect, knocking down other banks and nonbanking firms in their path. Some have used this fear to justify special public policies toward banks to reduce both the probability and cost of failures. Indeed, arguments for considering banks special date back to Adam Smith (Short and Robinson 1997).

Analysts view banks as fragile because they have (1) low cash-to-asset ratios, (2) low capital-to-asset ratios, and (3) high demand-to-total-deposit ratios. Under these conditions, sudden large-scale withdrawals of deposits could force them to have to sell opaque and less-liquid earning assets at fire-sale losses that would exceed their capital and drive them into insolvency. Thus, their greater fragility might lead to greater breakage. But many items are fragile—fine glass, fine china, and even economists' egos, for example. Yet they do not necessarily break more often than less fragile items, but they receive more careful handling. Evidently, banks did too, at least in the United States and most developed countries before the introduction of

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special public policies to counteract the fragility. The market—shareholders, depositors, loan customers—appreciated the fragility and handled banks with greater care than other, less fragile firms. In the United States, for instance, the annual bank failure rate from 1870 to 1913, before the introduction of the initial bank safety net in the form of the lender-of-last-resort facilities of the Federal Reserve in 1914, was lower than either the failure rate for nonbanks in the same period or for banks from 1914 to 1994 (Kaufman 1996b). This low rate occurred despite legal and regulatory restrictions that prohibited banks from reducing risk as much as they may have wished through geographic and product-line diversification. Indeed, the U.S. banking structure appears to have been designed almost to maximize failures.

But the annual variance of the failure rate was substantially higher for banks than for nonbanks. Thus, in the few years when bank failures were numerous, they were very numerous. Moreover, the large-scale failures were consistent with the best known symptom of systemic risk: individual bank failures igniting an exploding series of further bank failures.

This pattern served to reinforce the public perception of bank failures as serious economic disasters. This perception rested at least partially on fear of the unknown. The public knows far less about the operation of banks and other firms that deal in intangibles than about the operation of firms that deal in tangibles such as steel, automobiles, or computers. For most, mystery shrouds the operation of banks and most other financial institutions; many cannot distinguish between factual and fictional descriptions. The failure of banks and financial institutions remains a favorite topic for both writers of fiction and scriptwriters for movies, particularly those who seek to portray scenes of widespread fear and suffering.

Although the lumpiness of bank failures suggests systemic risk, it does not by itself constitute proof. The evidence from many countries strongly suggests that bank failures follow problems in the overall or regional macroeconomy rather than either igniting them or resulting from a shock wave set in motion by the failure of a single bank or a small number of banks, although wide-scale bank failures do exacerbate problems in the real sector. (The evidence is reviewed in Benston and Kaufman 1995, and a number of important essays are published in Hubbard 1991; see also Selgin 1992.) When many banks fail concurrently, the empirical evidence suggests that the failures occur among banks whose balance sheets are all exposed to the same credit and interest-rate risks (Kaufman 1994; Flannery 1995); that is, bank runs tend to be firm-specific or informational, rather than industry-wide.

Bank fragility reveals itself and bank failures occur most frequently when the macroeconomy experiences rapid inflation and, in particular, bubbles in

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asset prices and interest rates (Goodhart 1995; Schwartz 1987; Caprio and Klingebiel 1996; Nakajima and Taguchi 1995).[2] Because activities on both sides of the bank balance sheet effectively involve forward contracts priced on the basis of predictions of prices, income, employment, and interest rates, unexpected adverse changes in these variables have caused banks to suffer large losses from loan defaults and high costs of deposits. However, at least in the United States before the safety net, such losses were too small to drive more than a small percentage of banks into insolvency and even more rarely any even reasonably large and diversified bank into insolvency. When the appropriate economic incentives exist, at least large marginal depositors can differentiate financially healthy from financially sick banks and exert discipline on the latter. At the same time, banks can signal the state of their financial health to depositors and other customers by rearranging their asset and liability portfolios and changing their capital ratios. Unlike actual runs, the threat of runs exerts powerful market discipline (Kaufman 1988).

Nevertheless, even though U.S. banks before 1914 on average failed no more frequently than firms in other industries and depositors at failed banks lost less on average than creditors at failed nonbanks, the combination of periodic large-scale bank failures and the widespread fear of bank failures and systemic risk caused policymakers to impose special regulations on banks. In banking, the perfect became the enemy of the good. Almost every country has thrust some sort of safety net under banks through the central bank's lender-of-last-resort facilities, deposit insurance, or both. Deposit insurance is often implicit rather than explicit, especially in countries where the government owns or operates one or more large banks. Depositors at these banks assume that the government views the deposits as its own debt obligations and would not permit a default. So far, these depositors have been proven right in every case I know: depositors at no state-owned bank appear ever to have lost a penny of their principal. Hence, the depositors have exerted little discipline on the banks, and, although some of the banks have had prolonged periods of economic insolvency, they have been able to continue operations because the depositors have not withdrawn their funds. Where private banks have competed with the state-owned banks, the implicit insurance has spilled over to them. Otherwise, dramatic shifts of funds would have occurred from the possibly not fully insured private banks to the fully

2. This association appeared in both the United States and Japan. The magnitude of the asset bubble in Japan may be gauged by the fact that stock market prices declined by more than 60 percent from their peak in 1989 to their trough in 1992 and urban real estate prices by nearly 40 percent between their peak in 1991 and trough in 1994. An estimated 60 percent of the collateral underlying loans at Japanese banks was reportedly in real estate (Nanto 1995). Summary accounts of the Japanese banking crisis appear in English in Cargill, Hutchinson, and Ito (1996, chap. 6), Ito and Veda (1993), Nanto (1995), and Ostrom (1992–95).

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insured state-owned banks. Implicit deposit insurance dominates any coexisting explicit insurance that does not cover all deposits or depositors.

Thanks to the implicit insurance that allows economically insolvent banks to avoid closure, governments can use such banks to allocate credit to the most politically desirable borrowers rather than the most efficient or profitable ones. State-owned banks frequently are banks in name only; they act more as an arm of government policy.[3] Indeed, the use of even privately owned banks to generate political favors for the chartering government is as old as the granting of the first private bank charter. Early banks were chartered to extend loans at below-market rates to the chartering government, often to finance armed conflicts and adventures abroad. To enhance the profitability of the banks, governments granted only a limited number of charters, thereby bestowing various degrees of monopoly power. Frequently, the government taxed the resulting large earnings or participated directly in the ownership. In the early United States, some states, prohibited by the federal Constitution from the profitable business of printing currency directly, did so indirectly through the notes and deposits of private banks chartered by them and received significant portions of their tax revenues from taxes on bank profits (McCarthy 1984; Wallis, Sylla, and Legler 1994; Sylla 1995).

Because they are highly profitable in monopolistic environments, an efficient mechanism for bestowing political favors, and useful for implementing public policies indirectly that governments may be reluctant to implement directly, state-owned or -operated banks frequently comprise the last industry governments willingly privatize or surrender control over. They would rather relinquish steel, transportation, or utility firms than banks. Among the many advantages that the United States enjoys relative to most other countries is that it has had no state-owned banks since the First and Second Banks of the United States, the latter of which was liquidated in 1836 and both of which, although privately owned, performed many government functions.

Thus, although banks may not fail more frequently in a market economy or give rise to more adverse consequences of failure than other firms of similar size, they are special inasmuch as governments use them to generate revenues, allocate credit, and bestow political favors. Their government-provided safety nets are frequently so poorly designed that they are counterproductive. Together with poor macroeconomic policies that have encouraged inflation and price bubbles in a number of important assets, safety nets have contributed to creating the worldwide banking debacles of the last two

3. In Japan the postal savings system seems to be a case in point (Cargill, Hutchinson, and Ito 1996).

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decades at least as much as, if not more than, they contributed to preventing them (Kaufman, 1996a). It follows that avoiding bank debacles in the future hinges importantly on eliminating the flaws in the design of deposit insurance.[4]

The Implications of Poorly Designed Deposit Insurance Structures[5]

If poorly designed, safety nets in the form of deposit insurance, as well as in the form of lender of last resort and settlements finality by the central bank, have both good and bad effects.

The good effect is that, if deposits are fully protected up to some maximum amount, credible insurance prevents runs by small depositors who have doubts about the solvency of their banks and seek to exchange bank deposits for currency. Such runs would drain reserves from the banking system as a whole and give rise to potential multiple contractions in aggregate deposits (money) and credit.

Bad effects are as follows:

1. Moral-hazard behavior by banks is encouraged. Insured banks adopt lower capital-to-asset ratios and riskier credit and interest-rate portfolios as depositors and other bank customers exert less discipline.

2. Principal-agent problems between the regulator agent and the financially healthy bank and taxpayer principals intensify. Regulators have little or no incentive to recognize and resolve economically insolvent institutions promptly, as depositors do not flee from insolvent banks as before. Deposit insurance in effect shifts the control of the timing of the resolution of insolvencies from the market—through runs and liquidity problems—to the regulators. As a result, to minimize adverse pressures on themselves, regulators may allow insolvent institutions to remain in

4. In light of the seriousness of the past problems caused by the safety net, it may be asked: Why not eliminate the net outright rather than try to reform it? My reading of recent history suggests that it is politically impossible to do so. Every country has either explicit insurance for at least small depositors or implicit insurance for all depositors as soon as any problem arises. All deposits at state-owned or -controlled banks are effectively automatically insured. Even Argentina, which explicitly underwent a full elimination of deposit insurance in the early 1990s, quickly reinstated it when problems arose only a few years later. Thus, attempts to repeal deposit insurance or the central bank's lender-of-last-resort facilities outright are likely either to fall entirely on deaf ears or to be self-defeating. The pros and cons of preferring insurance reform to repeal are discussed further in Dowd (1996) and Benston and Kaufman (1996).

5. Parts of this section and the "What Can Be Learned from the 1991 U.S. Deposit Insurance Reform" section of this article are adapted from my paper, "Lessons for Transitional and Developing Economies from U.S. Deposit Insurance Reform."

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operation longer and losses tend to increase.[6] This problem particularly affects state-owned banks that engage heavily in credit allocation, which may have contributed to their insolvency.

These effects appear universal, occurring in banking systems in countries that differ greatly in economic, political, cultural, and legal structure. Unfortunately, observers often see the good effects of the safety net first and the bad effects, which increase the fragility of banks, only later, when they are costlier to correct. For many countries, later is now.

More specifically, Kane (1996) has identified five more or less sequential propensities that entrap bank policymakers in almost all countries and hinder their efforts to act as faithful agents for their healthy bank and taxpayer principals:

1. The *ostrich reflex*: the officials stick their heads in the sand and refuse to see the problem.

2. The *denial or dismissal reflex*: the officials deny the seriousness of the problem, dismiss its significance, criticize as irresponsible those who argue otherwise, and release disinformation to calm those still concerned.

3. The *cover-up reflex*: the officials attempt to hide their past actions, after the seriousness of the problem increases to the point that it can no longer be denied.

4. The *distraction reflex*: the officials attempt to direct public attention away from themselves and toward other problems, for which other officials are responsible.

5. The *whitewash reflex*: the officials attempt to rewrite history to leave themselves blameless.

U.S. officials yielded to all five propensities during the banking crisis of the 1980s, as have the officials in other countries as a rule during their banking crises (Kane and Kaufman 1993). Any reform of deposit insurance or the broader safety net needs to include provisions that minimize if not prevent both moral-hazard and principal-agent problems.

Indeed, the introduction of the safety net has increased the fragility of banks by encouraging them to reduce their capital-to-asset ratios at the

6. Such agency problems are reported to be serious in Japan. The *Wall Street Journal* reported that the Taiheiyo Bank was closed at the end of March 1996 but not before the liabilities of the $5.5 billion deposit bank exceeded its assets by $1.2 billion. Except for a small ATM run on the last day, depositors did not run on the bank in its last six months, although small deposit losses had been reported at a number of other "small" banks since November 1995 (Sapsford 1996). Forbearance in the resolution of previous insolvent banks in Japan is discussed in Cargill, Hutchinson, and Ito (1996), Kane (1993), Nanto (1995), and Folkerts-Landau and Ito (1995).

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same time that they were increasing both credit and interest-rate risk in their asset and liability portfolios. As a result, the banks became less able to withstand adverse economic shocks, and insolvencies increased in both average frequency and importance. By far the two worst episodes of bank failures in U.S. history occurred after the imposition of the safety net. The first occurred during the Great Depression of 1929 to 1933, less than twenty years after the establishment of the Federal Reserve and the introduction of its lender-of-last-resort facility. The second occurred in the 1980s, fifty years after the introduction of deposit insurance by the FDIC and less than twenty years after the introduction of finality by the Federal Reserve on real-time, uncollected large-value fund transfers on its Fedwire, which gave rise to intraday or daylight overdrafts until day-end settlement. All these parts of the safety net were and in most instances still are badly underpriced. This pattern suggests that, although market failures in banking may be more frequent, regulatory (government) failures are larger and more costly when they do occur.[7]

Clearing the Decks for Deposit-Insurance Reform: Resolving Insolvencies and Recapitalizing the Banking System

Effective and lasting deposit-insurance reform requires that the banking system and most individual banks first be adequately capitalized, so depositors would be willing to maintain their funds at banks without government guarantees. Depositors will maintain funds at insolvent or inadequately capitalized banks only if the funds are credibly guaranteed, explicitly or implicitly. Without such guarantees, depositors would run either to individually adequately capitalized domestic or foreign banks or to currency. But, as we have seen, government guarantee programs frequently create incentives for banks and regulators to engage in undesirable moral-hazard and agency behavior, respectively, that contributes substantially to the causes and magnitude of bank failure. Any reform program introduced before these problems are corrected will serve only as a facade soon to be undermined and come tumbling down. Indeed, in many countries, the task is not to introduce deposit insurance for the first time but to narrow and make explicit the existing implicit and all-encompassing guarantee structure.

7. In basically free-market economies, market and government regulation of banking compete with each other. When people perceive one to be working poorly, support grows for the other. A market-government regulation cycle may be depicted as

> Market regulation→ market failures→ "horror" stories→
> government intervention and regulation→ government failures→
> government deregulation→ market regulation→

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When any firm becomes economically or legally insolvent, so that the market value of its assets is less than the market value of its liabilities, its shareholders, creditors, and managers bear losses. In time, the firm's assets are sold to new shareholders, or to other firms through merger, or they are liquidated. Which outcome occurs depends on the demand for the firm's output. If demand is sufficient, the firm will be recapitalized as an independent entity or merged with another financially healthy institution. Liquidation occurs only if demand is insufficient.

Banking works the same way. If demand is sufficient for an insolvent bank's services, the institution is unlikely to be liquidated and disappear. But deposit insurance and the fear of imposing losses on depositors—for reasons of perceived loss of banking services, systemic risk, political backlash, and such—often delay resolution and shift the loss to the deposit insurance agency or the government. To conceal the loss, governments may merge "sick" banks with "healthy" banks. Such a merger frequently requires financial assistance to the healthy bank to absorb the sick bank, particularly if the insolvency is large.[8] To avoid out-of-pocket payments, the government promises the acquiring banks that it will guarantee some or all of the acquired assets or deposits. In some countries, in which few if any major banks are economically solvent, badly insolvent banks are merged with less insolvent banks. Such a merger is not a lasting solution. Instead, it is likely to lead only to larger, more insolvent, and even harder to resolve banks, which will cause bigger and more costly problems later. In addition, excessive mergers and consolidations may reduce competition, efficiency, and the incentive of larger and more monopolistic insolvent or near-insolvent banks to privatize or recapitalize themselves. The larger a bank, the more its actions are likely to resemble those of a state-owned bank.

It would be better for the insurer or government recognize and assume the losses of existing bank insolvencies when they first occur and in most cases to keep the individual banks independent as much as possible by selling the insolvent banks (less their economic insolvency) to new domestic or foreign shareholders or to smaller solvent domestic banks (Kaufman 1997).

In the absence of credible guarantees by well-capitalized banks, any lasting negative net worth in the banking system, whether explicitly recognized or not, becomes effectively part of the central government's debt. The insolvent banks are substituting public capital for private capital. This substitution represents a governmental policy of capital forbearance and is part of the agency problem discussed earlier. But unlike private capital, the public capital shares in only the downside risk. If the banks return to profitabil-

8. A description of this policy in Japan appears in Cargill, Hutchinson, and Ito (1995, 1996) and Kuroda (1996).

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ity and eliminate their negative net worth, the public capital is effectively canceled and all the returns accrue to the private shareholders. Moreover, the longer the banks' private net worth remains negative, the more likely the banks will continue to generate losses from continuing their regular ongoing activities that have been unprofitable in the past and from additional moral-hazard gambling for resurrection (Eisenbeis and Horvitz 1994; Brinkman, Horvitz, and Huang 1996; Kane and Yu 1996). For the same reason, they are also more likely to engage in fraud and self-dealing and, because they have less incentive and ability to operate effective internal control systems, they are also more likely to become victims of such schemes by outsiders.

Operating insolvent institutions compete unfairly with solvent institutions by both underpricing their loans and overpricing their deposits. As long as their private net worth is negative, the insolvent banks are effectively government-owned (nationalized) but privately managed. But, in return for permission to remain in operation, the private managers tend to be highly sensitive to government intervention in a number of areas such as credit allocation. As noted earlier, although politically profitable, such policies are unlikely to be financially profitable through time. Thus, this arrangement is unstable and potentially explosive.

Whether the situation is officially recognized or not, the government is financing the banks' private negative net worth. If not explicitly recognized as part of government debt, the banks' deficit is financed through bank deposits. If explicitly recognized, it is financed by additional tax receipts or new debt. Which costs more depends on the interest expense and noninterest expense of explicit government debt versus that of explicitly or implicitly insured bank deposits. At least in the United States, explicit government debt had a lower interest cost in the 1980s than bank deposits. Moreover, even if explicit government debt costs more, it may still be the better way to finance the banks' negative capital position if the government can at the same time impose more effective rules to resolve the insolvencies more quickly and restrict moral-hazard gambling until then.

But, for political reasons, government officials may prefer not to recognize the government's obligation; the larger the magnitude of the banks' negative net worth, the greater their reluctance to do so. Among other things, recognition involves admitting past errors, accepting blame, forcing an explicit or implicit write-down of bank assets from book to market value, and potentially exposing fraud and other criminal activity in addition to "honest" errors of bank mismanagement. Moreover, it may foster a widespread perception that the government budget deficit will increase and as a result raise interest rates and that the government funds will be used to "bail out" the "guilty" bank managers and shareholders. Thus, governments are tempted to delay taking this step as long as possible, until the severity of the

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problem becomes so widely recognized and so explosive if not corrected that the costs of remaining in the ostrichlike position, hoping to last until a successor becomes responsible, finally outweigh the benefits (Kane 1993).

In the United States, the initial legislative response to the thrift problem of the 1980s did not occur until some eight years after the massive initial decapitalization of the thrift industry, and then only in the form of insufficient and industry-financed support in the Competitive Equality Banking Act (CEBA) of 1987. Appropriation of public funds for the thrift debacle did not occur until two years later in the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) of 1989. Recognition of the concurrent problem in commercial banking, appropriation of public funds for that purpose, and meaningful deposit-insurance reform did not occur until 1991, with the enactment of the FDIC Improvement Act (FDICIA).

Neither the government nor the bank regulators took the lead in exposing the problems and warning the public of their consequences. It was the analyses of some academics and independent staff members of the bank regulatory agencies and congressional banking committees that importantly contributed to alerting the media and ultimately the public to the seriousness of the problem. Indeed, consistent with the previously noted Kane reflexes, officials criticized and belittled the "truthsayers," denying and dismissing their message as the ravings of uninformed, permanent critics. After all, according to the regulators and the government, everyone knew or should have known that they—the regulators and the government—had more analysts and better access to the data and were the true guardians of the public welfare! One can observe a similar pattern in other countries.

Public support for official government intervention and explicit assumption of the banks' negative net worth might be easier to obtain if the government were to make it clear from the outset that the funds raised would be used for liquidating the assets of the insolvent institutions and not for supporting the shareholders or management. The government could signal its commitment by establishing an independent liquidating agency— a government-sponsored "bad bank"—to which all insolvent institutions would be transferred. The agency, which could be modeled in large part after the Resolution Trust Corporation (RTC), would be charged with selling the insolvent institutions as a whole or their assets separately in a quick but orderly fashion. In the meantime, the agency would appoint and oversee the management of the transferred banks. The government could allow currently insolvent institutions to avoid being transferred to this agency if, in a short period, they raised sufficient private capital to meet the capital standards discussed in the following section.

The elimination of the individual bad banks and the negative net worth

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in the banking system is primarily a political problem. The question is not so much whether they should be eliminated but when and who should, and practically or politically could, bear the cost—depositors, shareholders, healthy banks, or nonbank taxpayers. The answer hinges on the strength and will of the central government. The size of the banks' deficit is given, only the distribution of the burden is at stake. In such a setting, questions of economic efficiency are frequently of secondary importance. That is why it is so difficult for governments in many countries to take this step. Generally, it is possible only after lengthy delays during which alternative means of allocating the costs prove unacceptable. If and when the insolvent and near-insolvent institutions have been recapitalized or transferred to the resolution agency, the government should put in place a new, efficient deposit insurance structure. This task is primarily an economic problem. The deposit-insurance reform legislation enacted in the United States in 1991 can serve as a partial model.

What Can Be Learned from the 1991 U.S. Deposit-Insurance Reform?

Congress changed the deposit insurance system dramatically in 1991 in response to the major savings-and-loan debacle of the 1980s, in which one-quarter of the S&L industry failed at a cost of some $150 billion to the U.S. taxpayers, and the fear arose that the commercial banking system was about to experience similar problems (Kane 1989; Kaufman 1995). Some 1,500 banks had failed, and the FDIC had effectively exhausted its reserves. Taxpayers exerted substantial pressure on Congress and the administration to reform bank regulation and the deposit-insurance system to reduce both the likelihood and the costs of such debacles in the future. As a result, a brief opportunity appeared in 1991 both to recapitalize the industry with public funds and to introduce major changes to correct the flaws in the deposit-insurance structure. This opportunity did not exist before the debacle; nor, in retrospect, would it have remained much longer as the banking and thrift industries recovered, easing public pressure to make changes. The banks' improved performance also would have increased the opposition to such changes by those in the industry likely to be adversely affected, including regulators who wished to continue the existing system of regulation and legislators who wished to continue the existing system of "selling" political favors. At the height of the crisis, neither bankers nor bank regulators had sufficient public credibility and stature to fight the reforms effectively. The situation in Japan today seems similar.

Deposit insurance differs fundamentally from other forms of insurance, such as life, property, or fire insurance. Although the firms that sell the lat-

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ter insurance can partially control moral-hazard behavior and reduce the likelihood of the insured event's occurring by requiring preventive behavior or action (e.g., smoke detectors, safety belts, more solid construction), they cannot prevent the events from occurring altogether. Some remain "acts of God." Depositor insurers, however, can control their loss experiences almost totally by resolving insured institutions before they deplete their shareholder capital completely. The loss is endogenized. Outside of the event that inadequate monitoring, major fraud, or very large, abrupt declines in asset prices occur, only shareholders would suffer losses in bank insolvencies and the deposit insurance would become effectively redundant.

Framers of the 1991 changes in the deposit-insurance structure sought to keep the good aspects of deposit insurance—full protection for only small depositors to minimize runs into currency—and to correct the bad aspects—the risk-taking, moral-hazard behavior of insured institutions and the forbearing behavior of regulators as agents for their healthy bank and taxpayer principals (Benston and Kaufman 1988, 1994b; Carnell 1993a, 1993b).

The underlying premise of the reform was that limited government deposit insurance was not only politically realistic, but economically beneficial if designed correctly. Continuation of government deposit insurance requires continued supervision and regulation of banks by the government, but not necessarily as before. The incentives of both the insured institutions and the bank regulators had to be changed in order to change their behavior in the future and thereby to avoid the reestablishment of underlying conditions for debacles, for example, excessive credit and interest-rate exposures by banks. In the jargon of economics, the structure had to be made "incentive compatible." Moreover, because, as noted earlier, if any troubled institution was resolved before its own private capital was fully depleted, losses would accrue only to shareholders and not to depositors and other creditors, an explicit and firm "closure rule" must apply. The numerical cutoff value selected for this rule must be set somewhat above zero capital in order to provide a safety margin for errors and minimize incurring losses from all but major fraud or unusually large and sudden declines in asset values that could drive capital negative before resolution could be achieved. Indeed, without an explicit and firm closure rule, no deposit-insurance reform scheme can be effective. Shareholders receive any economic value remaining in the bank when it is resolved. No private capital is expropriated. Any losses from delayed resolution would be shared by the FDIC and depositors with uninsured deposits.

Because, with such a closure rule, losses to depositors at failed banks would be minimized or avoided altogether, systemic risk problems also would be minimized. For purposes of public policy, one should view the failure of banks as no more important or damaging than the failure of any other

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firm of comparable size, and one should not disguise economic insolvencies by manipulative accounting. The magnitude of any loss associated with failure matters much more than the failure per se. The approach I have described is referred to as structured early intervention and resolution (SEIR) or, in the language of FDICIA, prompt corrective action (PCA) and least cost resolution (LCR) (Benston and Kaufman 1988).

The underlying strategy calls for regulatory sanctions to mimic the prudential sanctions (penalty function) that the private market imposes on financially troubled non-insured firms as their condition deteriorates. Such sanctions include reducing or eliminating dividends, restricting asset growth and acquisitions, changing management, and raising additional capital. To limit moral-hazard behavior, the new structure imposes explicit and progressively harsher sanctions as a bank's financial condition, measured primarily by its capital position, deteriorates; it thereby affects the bank incentives *ex ante* and attempts to reverse its decline and to avoid its failure. If this procedure fails and the existing shareholders do not recapitalize the bank, it must be resolved before its economic capital turns negative. Insolvent banks should be given no opportunities to "gamble for resurrection" with potential large losses to the FDIC.

The new structure specifies explicit and preannounced multiple performance zones or trip wires for banks with different associated explicit and preannounced sanctions and, equally important, rewards. The top performance zone requires levels of capital adequacy in line with the capital ratios maintained by uninsured bank competitors. The poorer a bank's performance—the lower the performance zone—the harsher the regulatory sanctions ("sticks") and the smaller the rewards ("carrots"). Conversely, the better the performance, the milder any sanctions and the greater the rewards. Such a multiple-step performance-evaluation ladder has two major advantages. First, it contains carrots as well as sticks to encourage better than satisfactory or adequate performance, which sanctions alone cannot do. Second, one can graduate the harshness of sanctions moderately. Small steps make banks view the implementation of sanctions as more likely, increasing their credibility, and decrease the banks' incentive to increase their moral-hazard behavior sharply as they approach the floor values of a particular zone. With only a two-zone scale—open or closed—the increase in the sanctions becomes too great to be highly credible, and banks are more likely to increase their risk taking significantly as their performance declines toward the lower boundary of the open zone.

The success of this structure depends on the quality and motivation of the bank supervisors and regulators. However, the strict regulatory discipline is supplemented by increased reliance on market discipline from larger, de facto as well as de jure uninsured depositors and other creditors, who are

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accustomed to and experienced in evaluating the credit worthiness of their investments. The combination of intensified regulatory and market disciplines should greatly reduce the likelihood of banks sinking through all the zones and failing. If some did so, they most likely would experience a "soft landing" with minimum losses.

To limit the agency problem, the regulatory sanctions are explicit and become progressively more mandatory (less discretionary) as an insured institution's performance deteriorates. This graduation reduces the ability of regulators to delay, forbear, and treat different banks differently.[9] But regulators retain their freedom to use discretion in the higher performance zones. The use of explicit multiple performance zones and the resulting moderate changes in the severity of the mandatory sanctions should make regulators less reluctant to impose them and, therefore, also less opposed to the mandatory feature and the loss of some of their discretionary authority in the lower performance zones.

Table 1 presents a summary of the major features of the deposit-insurance structure imposed by the FDICIA. The reforms were phased in concurrently with the elimination of the negative net worth in the industry through the resolution of insolvent and near-insolvent institutions. These provisions apply to all surviving banks and savings-and-loan associations. Five capital zones were put in place. Three capital-asset ratios—risk-based total and tier 1 and leverage tier 1—serve as the primary measure of performance. With the exception of the requirement of a minimum 2 percent tangible equity leverage capital for critically undercapitalized banks, which the legislation specifies, the regulatory agencies set numerical values for capital for each of the other zones.

Unfortunately, although the legislation encourages use of market-value accounting, capital is measured in book (historical) values rather than the more accurate and useful market values. Because book values frequently overstate market values, the currently specified values of the capital levels for each zone are probably too low either to always impose sanctions in a timely and preventive fashion or to always resolve critically undercapitalized institutions with no or only minimal loss to the FDIC.[10] In addition, the risk-based capital measures are arbitrary, can be "gamed" by the banks to show higher values than warranted, and tend to overstate the size of a bank's

9. The FDICIA also imposed limited restrictions on Federal Reserve discount-window lending to insolvent or near-insolvent institutions.

10. However, for purposes of protecting domestic depositors and the FDIC, the capital ratio of large banks was effectively increased sharply in 1993 with the enactment of depositor-preference legislation that gives domestic depositors and the FDIC preference in resolution over foreign depositors and nondepositor creditors, including sellers of Fed funds.

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Table 1. Summary of Prompt Corrective Action Provisions of the Federal Deposit Insurance Corporation Improvement Act of 1991

Zone	Mandatory Provisions	Discretionary Provisions	Capital Ratios (percent) Risk-Based Total	Risk-Based Tier 1	Leverage Tier 1
1. Well capitalized			>10	>6	>5
2. Adequately capitalized	1. No brokered deposits, except with FDIC approval		>8	>4	>4
3. Undercapitalized	1. Suspend dividends and management fees 2. Require capital restoration plan 3. Restrict asset growth 4. Approval required for acquisitions, branching, and new activities 5. No brokered deposits	1. Order recapitalization 2. Restrict interaffiliate transactions 3. Restrict deposit interest rates 4. Restrict certain other activities 5. Any other action that would better carry out prompt corrective action	<8	<4	<4
4. Significantly undercapitalized	1. Same as for zone 3 2. Order recapitalization* 3. Restrict interaffiliate transactions* 4. Restrict deposit interest rates* 5. Pay of officers restricted	1. Any zone-3 discretionary actions 2. Conservatorship or receivership if fails to submit or implement plan or recapitalize pursuant to order 3. Any other zone-5 provision, if such action is necessary to carry out prompt corrective action	<6	<3	<3
5. Critically undercapitalized	1. Same as for zone 4 2. Receiver/conservator within 90 days* 3. Receiver if still in zone 5 for 4 quarters after becoming critically undercapitalized 4. Suspend payments on subordinated debt* 5. Restrict certain other activities				<2

*Not required if primary supervisor determines action would not serve purpose of prompt corrective action or if certain other conditions are met.

Source: Board of Governors of the Federal Reserve System.

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cushion to absorb losses of all types.[11] Moreover, despite their weakened state, the regulators and banking industry had some success in lobbying Congress to water down some of the prudential provisions before enactment and later in drafting implementing regulations that further weakened the intent of the act (Benston and Kaufman 1994a; Kane 1994).

Nevertheless, the new structure has many advantages:

—It requires little modification of the existing banking structure.

—By simulating a market environment in which noninsured firms operate, it is incentive compatible.

—It relies on both "carrots" and "sticks" to motivate bank behavior.

—Because the sanctions mimic market forces and are broad, they reduce the need for regulatory micromanagement.

—It maintains full explicit protection for "small" depositors, who are likely to run into currency, unlikely to be very efficient in evaluating the financial condition of banks, and most likely to successfully pressure the government for protection if losses from failure threaten.

—Insurance is explicit, so the rules are known beforehand and political fighting regarding coverage is minimized at or after a failure(s).

—By restricting deposit insurance to $100,000 and not protecting uninsured deposits, market discipline is permitted to supplement regulatory discipline at larger banks.

—There is no need for "too-big-to-fail" (TBTF), which really means "too-big-to-not-protect-uninsured-depositors." If a bank of any size is resolved promptly, losses to depositors should be small at worst, hence concern about systemic risk minimal. FDICIA does provide an exception that permits protecting all depositors at institutions if not doing so "would have serious adverse effects on economic conditions or financial stability." But the use of this exception requires a number of difficult steps, including effective approval by the president of the United States and repayment of any loss to the FDIC primarily by other large and competitor banks, whose owners might reasonably oppose providing such assistance. Thus, it is unlikely to be used frequently.

—Insurance premiums would be low, because losses to the FDIC would be low and needed primarily to pay the FDIC's operating expenses.

11. References to a criticism of risk-based capital standards are noted in Kaufman (1997). One can observe the misleading nature of the use of book values and risk-based capital as well as underreserving losses by noting that the reported BIS risk-weighted capital ratio of Japanese banks actually increased between early 1992 and 1994, during the height of the banking crisis (data from Goldstein and Folkerts-Landau 1994).

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—Prudential regulation would increase in credibility.

—As the rules are explicit and known ahead of time, they help to shape the expectations and behavior of banks.

—By making some sanctions, including ultimate resolution, mandatory, the law lessens political pressures on regulators, who have no choice but to take the legislatively specified actions, which may be politically unpopular.

Since its introduction, FDICIA has had positive effects. Together with high bank profits from a prolonged period of economic expansion since 1991; a low level of interest rates; a steeply upward slope of the yield curve; and no return of price bubbles in energy products and real estate, which contributed importantly to the earlier losses, the market's fear of sanctions for being undercapitalized has caused banks to maintain significantly higher capital ratios than in any other period since the early 1960s. These same factors, as well as the taking of prompt corrective actions, have helped reduce the number of bank failures from some 125 in 1991 to fewer than 10 each in 1995 and 1996. Only infrequently and less so in the most recent years have uninsured depositors received protection at banks resolved with a loss to the FDIC (Benston and Kaufman 1997). Thus, in contrast to pre-FDICIA days, market participants know that uninsured depositors at all failed banks probably will experience some loss if the FDIC suffers a loss. This knowledge has served to strengthen market discipline on banks.

What should other countries copy from the U.S. experience? Among the most important lessons are

—Keep or impose explicit full protection for small depositors, but not for larger depositors, who have the ability and experience to evaluate credit worthiness and are accustomed to experiencing losses.

—Make all sanctions explicit and some, including ultimate resolution (the closure rule), mandatory. To minimize political fighting when sanctions have to be imposed, to achieve fairness, and to affect *ex ante* bank and regulatory behavior, permit no exceptions.

—Resolve pending insolvencies sooner rather than later, so any losses will be smaller and the insurance agency can pay them without subterfuge or forbearance.

—Intervene in problem institutions promptly, to raise the odds of turning them around and avoiding insolvency.

—Specify multiple performance zones, making the sanctions moderately graduated, credible, and enforceable.

—Charge deposit insurance premiums related to the risk exposure an institution represents to the insurer to discourage moral-hazard behavior, but

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recognize that the insurer's loss depends on the closure rule and that risk premiums require an accompanying closure rule.

—Develop adequately trained and motivated supervisory and regulatory personnel.

—Require sufficient economic capital. Only capital can absorb losses and avoid insolvencies. The greater the risks from the macroeconomy, financial markets, and inadequately trained or motivated bankers or supervisors, the higher should be the required capital. The "correct" capital is the amount the market would require if the bank were not insured. This may be judged by the capital ratios maintained by noninsured bank competitors in the particular country. Generally, these ratios substantially exceed those of the banks, even under FDICIA. The lesson from the history of banking is clear: it is far cheaper in the long run for both banks and the economy as a whole to err on the side of requiring too much capital in banks than too little.[12]

Conclusions

Although frequently considered special, banks are not unique with respect to their stability or the damage caused by their failure. To the extent that banks are special, special public policies, particularly safety nets and the banks' usefulness in taking actions indirectly that governments may be reluctant to take directly and in bestowing political favors, make them so. Ironically, some of the prudential policies imposed on the banks have been so poorly designed that they have been counterproductive, increasing the fragility of the banks to adverse economic shocks. This heightened vulnerability has resulted in more frequent and costly failures in almost all countries, spuriously validating the widespread fears that bank fragility translates into bank failure. In the absence of reductions in the magnitude or frequency of economic shocks, governments can improve bank stability by correcting the flaws in the existing design of the safety net, particularly government-operated deposit insurance, that encouraged moral-hazard behavior by the banks and poor agency by the regulators.

The United States reformed its deposit insurance structure in the FDICIA of 1991 to reduce the incentives that foster both problems. The reform rests on the truism that if a bank is resolved before its economic net worth turns negative, only shareholders, not depositors, bear losses. Deposit insurance becomes effectively redundant. The reform attempts to achieve this outcome by explicitly maintaining insurance for small depositors;

12. For countries with state-owned banks, it is necessary to capitalize them separately or, better yet, privatize them and subject them to the same prudential provisions required of competing private institutions.

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increasing bank capital levels; imposing graduated regulatory sanctions that mimic market sanctions on troubled noninsured bank competitors and that become progressively harsher as a bank's performance deteriorates through a number of performance zones, making the imposition of the sanctions by the regulators more mandatory as the bank's performance deteriorates; and introducing a closure rule that requires resolution before the total dissipation of a bank's capital.

This structure has a number of attractive features that recommend it to other countries, particularly developed ones. Developed countries generally have better capitalized banking systems and the financial resources, although not always the political will, to recapitalize individual insolvent banks, which are too often state-owned institutions. They also have a highly educated and sophisticated labor force from which to attract bank regulators and supervisors. Thus, they possess the most important prerequisites for the successful implementation of this reform. Less-developed countries are likely to have more poorly capitalized, often insolvent, banking systems; to encounter more serious constraints in recapitalizing them; and to have fewer educated and trained bankers and examiners. These conditions make these reforms more difficult, but not impractical nor unimportant, to implement in these countries. To date, the scheme has worked well in the United States in reducing both the number and cost of bank failures and in raising capital ratios. It took effect only after the bank and thrift systems had been recapitalized with public funds and insolvent institutions resolved by an independent agency. High bank profits from a continuing economic expansion, elimination of price bubbles, and a favorable interest-rate structure assisted its success. Ultimately, no deposit-insurance reform can substitute for or long survive in the absence of effective stabilizing macroeconomic policies that avoid inflation and asset-price bubbles.

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This article was originally prepared for presentation at the annual meeting of the Japanese Society of Monetary Economics in Tokyo on 25 May 1996. As a result, periodic references are made to Japanese banking. I have benefited greatly from conversations and comments on both the Japanese banking situation and earlier drafts of this article by many persons, including Hesna Genay (Federal Reserve Bank of Chicago), Thomas Cargill (University of Nevada, Reno), Edward Kane (Boston College), and two anonymous referees.

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Nikolai Bukharin and the New Economic Policy

A Middle Way?

JONATHAN J. BEAN

Socialists have long searched for a "middle way" between the free markets of capitalism and the hypercentralization of a Soviet-style command economy. In the late 1980s Soviet reformers returned to the New Economic Policy (NEP) of the 1920s and the ideas of Bolshevik leader Nikolai Bukharin, chief apologist for the NEP. The reformers argued that Bukharin's NEP, with its mixed economy, was a viable model for "market socialism." The NEP alternative, however, was a failure. Bukharin had hoped the NEP would demonstrate the superiority of socialist enterprise, but after its implementation capitalist entrepreneurs prevailed in open competition with state-owned firms. Bolshevik price controls distorted market relations and led to the demise of the NEP. Various attempts to revive the NEP occurred in the ensuing years, most markedly when Soviet leader Mikhail Gorbachev described his *perestroika* as a return to NEP-like policies, but the NEP model could not meet the crisis that plagued the Soviet Union. By rejecting socialism and committing himself to the principle of private property, Boris Yeltsin moved beyond Bukharin and the NEP.

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Origins of the New Economic Policy

When the Bolsheviks seized power in 1917 they had no economic plan. Lenin first introduced "state capitalism" to regulate big business, but stopped short of nationalization. In 1918, wartime emergency, coupled with ideological fervor, led to more extreme measures. The state nationalized all industry, banking, and trade. The Bolsheviks forcibly requisitioned grain from the peasants, abolished money, and paid workers in kind. The new government established a Supreme Council of the National Economy (VSNKh) to supervise industry and plan the entire economy (Ball 1987, 28, 6–8).[1]

The results were disastrous: industrial production declined to one-fifth the prewar level, and real income per capita dropped by 60 percent (Ball 1987, 6–8; Volin 1970, 163). The collapse of the economy contributed to the social unrest and uprisings of 1921. Consequently, at the Tenth Party Congress (March 1921), Lenin abandoned "War Communism" in favor of his "New Economic Policy" (NEP). He conceded that the NEP was a "retreat" and a "turning back toward capitalism"; however, he regarded "special transitional measures" as necessary to build socialism in a peasant country (Lenin [1921] 1960a, 188–89; [1921] 1960b, 214–18; [1921] 1960c, 429–30; [1921] 1960d, 329–36).

The party now sought a *smychka* (alliance) with the peasantry. The Bolsheviks replaced arbitrary grain requisitions with a tax in kind, thereby reducing the burden on the peasants. They abolished private property in land, but allowed free use of the land as long as it was cultivated. The government continued to control the "commanding heights" of the economy (large industry, foreign trade, banking, and transport), but created a private sector by denationalizing small industry and leasing factories to cooperatives and capitalist entrepreneurs. State factories were authorized to buy and sell goods on the open market and to do business with "Nepmen" (private merchants). By 1926, the private sector handled 75 percent of retail trade and produced 90 percent of agricultural output. Nepmen industrialists produced one-third of all consumer goods and played an important role in the service sector by opening restaurants, inns, and publishing houses (Nove 1982, 84–89, 98–100; Zaleski 1971, 28–29; Bandera 1963, 266–69; Ball 1987, 21–22, 140–47).

As the architect of the NEP, Lenin sought a technological solution to the problem of low productivity in Soviet industry. He appointed "bourgeois specialists" (non-Bolshevik engineers and economists) to positions on GOELRO (the state electrification commission) and GOSPLAN (the state planning agency). The Soviets acquired additional technical assis-

1. On the Marxist origins of "War Communism," see Roberts (1990).

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tance through the granting of foreign concessions (Guroff 1983, 211–17; Bailes 1978, 48–62; Sutton 1968–73, 1:5).

The NEP brought economic recovery. Prosperity increased tax revenue, and by 1925 the government enjoyed a surplus. However, in the years 1922 to 1923 a brief "scissors crisis" arose as agricultural recovery outpaced industrial recovery. Manufacturing prices rose to an extremely high level, while the state kept grain prices artificially low. Rather than sell their grain to the state, farmers sold it on the market, where prices were higher, or produced only enough for themselves, and urban food supplies were threatened. The crisis passed when the government lowered industrial prices through cost cutting and price controls (Nove 1982, 90–96; Volin 1970, 184–88).

Despite the return of prosperity, the party rank and file were ambivalent toward the NEP. Workers welcomed the end of rations and the reintroduction of money wages, but they opposed other aspects of the policy (Ashin 1988, 295–302, 306–12). To many, Lenin's "retreat" toward capitalism seemed a betrayal of the revolution—workers labeled the NEP the "New Exploitation of the Proletariat" (Ball 1987, 16). The egalitarian spirit of the revolution remained strong, and many resented the inequalities that developed under the NEP. Party members despised the luxurious lifestyles of the Nepmen and bourgeois specialists. The Bolsheviks hated merchants, whom they considered "speculators," not producers, even more than they hated industrialists (Ball 1987, 3–4). This anticapitalist mentality was consistent with Marxist doctrine: Marx taught that a person's outlook depended on his relation to the means of production; thus, if people engaged in capitalist pursuits, they would become capitalists in outlook (Millar 1981, 9).[2] Party loyalists also feared the corrupting influence capitalism might have on the communists themselves. Victor Serge noted with dismay that some Red partisans had become Soviet millionaires (Serge 1963, 201).

Poor working conditions intensified worker resentment of the Nepmen's success. Although real wages increased, unemployment remained high as the overpopulated countryside sent workers to cities. Rents were low, but housing was crowded and in disrepair. Worker control of factories gave way to stricter management discipline. Furthermore, industrial workers were now supervised by three layers of management: union representatives, factory managers, and party secretaries, who pressured workers to increase productivity. Factory managers hired workers on a temporary basis, enabling them to fire at will, and turnover and absenteeism were high (Chase 1987, 109–22, 142–44, 159–61, 176–95; Filtzer 1986, 25–27; Nove 1982, 115–16).

2. This animus against business also had its roots in Russian history. The entrepreneur was a reviled figure in prerevolutionary Russian culture. See Owen (1981), Rieber (1982), and Ruckman (1984).

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The NEP Debate

Although the NEP spurred economic recovery, the party leadership disagreed about the desired rate of industrialization and the methods used to finance it. The left wing of the party, led by Leon Trotsky and E. A. Preobrazhensky, called for accelerated industrialization. Preobrazhensky developed his "primitive socialist accumulation" theory, arguing that it was necessary to finance industrialization by extracting as much capital as possible from the peasantry through taxation and higher industrial prices. He predicted growing class divisions within the peasantry and the rise of a *kulak* (rich peasant) threat. Fearing foreign control, he preached economic isolationism and called for an immediate worldwide revolution. Preobrazhensky hoped for a quick end to the NEP and a shift toward a fully planned economy (Preobrazhensky [1922] 1979d, 20–30; [1925] 1979a, 33–41; [1926] 1979b, 48–49; [1926] 1979c, 65).[3]

Lenin and Bukharin, on the other hand, defended the *smychka* as a long-term policy. After Lenin's death in 1924, Bukharin became the leading defender of the NEP. He called the *smychka* "the fundamental question of our revolution" (Cohen 1973, 145). Like Lenin, he saw a "dual outcome": peasants could ally with the capitalist Nepmen or with the proletariat ([1926] 1982g, 111). Bukharin emphasized the importance of industrialization, but he believed that excessive exploitation of the peasantry might provoke a rebellion that could overturn the state.

Bukharin also rejected Preobrazhensky's static, zero-sum assumptions about the economy. He argued that the economy was dynamic and that peasant demand for manufactured goods was elastic. Lower industrial prices, he reasoned, would result in higher volume and greater aggregate profits ([1926] 1982c, 166–69). He cited the United States as an example of a nation that had built its industry upon a strong agricultural sector ([1928] 1982d, 310); he called for balanced growth and a slower "tempo" than that proposed by the Left; and he argued that the kulak threat was a myth, because the "rich" farmers represented only 3 percent to 4 percent of the peasantry (Cohen 1973, 187–92).[4] As all peasants (including the kulaks) prospered, he explained, tax revenue would increase and could be used to finance industry or be redistributed to poorer peasants ([1925] 1982a, 197–99). Most important, under NEP the peasantry would see the advantages of socialism (e.g., cheaper credit from the state, lower selling costs through

2. Preobrazhensky's theory reflected Marx's belief that the original accumulation of capitalism arose from the exploitation of the peasantry (Millar 1981, 12–13).

3. The richest 3 percent of peasants owned only 2.5 cows on the average, versus 1.1 for the peasantry as a whole (Bleaney 1988, 4).

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coops) and eventually come to prefer it to capitalism ([1925] 1982a, 198–99, 204–205).[5]

Bukharin had high hopes for the NEP experiment. He aspired to have the *smychka* serve as a model for developing nations and believed it might inspire a world *smychka* (Cohen 1973, 149, 169–70). Although his ultimate goal was a planned economy, Bukharin insisted that "we will reach socialism only through market relations" (Ball 1987, 45). Confident that the state could eventually "squeeze out" the Nepman, he called for a peaceful economic struggle with the private sector (Bukharin [1921] 1982b, 102–5; [1926] 1982g, 113).

The economist Peter Boettke notes the similarity between Bukharin's "creeping socialism" and the gradualism advocated by the Fabians. Like the Fabians, Bukharin envisioned a slow evolution toward socialism: "We are moving forward, little by little, pulling the heavy peasant carriage along behind" (Bukharin [1926] 1982c, 153). Bukharin also shared the Fabian belief in the superiority of socialist enterprise; the Bolsheviks would create their socialist utopia not through armed revolution but by "outcompeting the capitalists" (Boettke 1990, 187 n. 88). Bukharin wrote that "if they [the capitalists] sell cheaply, we must reach a position where we can sell still more cheaply" ([1925] 1982a, 189).

Bukharin's faith in the superiority of socialist enterprise rested on the Bolshevik belief that large firms could produce more efficiently than small ones. In his 1927 essay "The Road to Socialism," Bukharin asserted that *"large-scale production ultimately drives out small-scale production"* (1982e, 260; emphasis in original). State enterprises held other advantages over the Nepmen, including lower taxes and the financial backing of the government. The Nepmen of the 1920s were also less sophisticated than their prerevolutionary counterparts; fewer than one-third owned permanent shops, and very few formed joint-stock companies (Ball 1987, 92–93, 159).

Yet despite these disadvantages, Nepmen could compete successfully with state and cooperative enterprises. Private stores offered easy credit, better service, and a wider selection of goods. Cooperatives, on the other hand, were mismanaged and staffed with unfriendly clerks. Factories leased to Nepmen operated more successfully than those leased to state or cooperative enterprises. State firms even purchased supplies from Nepmen, who were more efficient and charged lower prices than cooperatives. "Transfer pricing" took place as state employees illegally transferred goods to Nepmen in return for bribes. Most important, the state lost out in the grain trade as

5. Bukharin's views resemble those of several GOSPLAN economists, including V. G. Groman and V. A. Bazarov (Jasny 1972, 107–38). Unlike Bukharin, however, Bazarov and Groman favored a permanent reconciliation of plan and market (Brus 1972, 46–47).

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Nepmen offered higher prices to farmers, thus threatening the *smychka* (Ball 1987, 110–21, 131–32, 148–51).[6]

The NEP proved untenable partly because it lacked credibility. Bukharin assured party loyalists that the survival of capitalism did not threaten the socialist experiment as long as the party held a monopoly of power; he quipped that in the Soviet Union there was "one party in power and the others are in prison" (quoted in Nahaylo 1989, 58; see also Bukharin [1925] 1982a, 200). But what assurance did the merchants or peasants have that the NEP would continue? Were the Bolsheviks War Communists or Nepmen? In 1920, Bukharin had defended War Communism; now he was championing NEP. Who was the real Bukharin?[7] Because the party disagreed about NEP, many observers feared a return to state control. A huge credibility gap also separated the official proclamations of the central party ("get rich!") and the hostile actions taken by lower-level officials against private entrepreneurs. Party activists joined with workers in expressing their resentment of Nepmen. One contemporary observer reported that "they have coined a new word—*nepman*—and no person who has not visited Russia can appreciate how mean a word it has become.... *Nepman*—symbol of degradation, object of scorn and contumely! Pariah, social swine!" (Ball 1987, 15). While Bukharin preached cooperation, the government produced anti-Nepmen propaganda in the form of movies, cartoons, and grammar-school lessons. No wonder the Nepmen and peasants were "afraid of what was to come" (quoted in Boettke 1990, 119; see also Ball 1987, 165; Boettke 1995, 254–56).

Bukharin recognized that unless the party firmly committed itself to NEP, the merchants and peasantry would refuse to cooperate with the government. He lamented that "the attitude of our comrades working in the countryside—men who were brought up on the system of War Communism—is such that they consider the best economic policy to be one of confiscating" ([1925] 1982a, 197). He also decried the heavy-handed tactics used to force small shopkeepers out of business. His fear was that these economic disincentives would have a chilling effect on private enterprise. Yet Bukharin's own writings contained class-war rhetoric. Although he advocated a peaceful struggle with the capitalists, Bukharin still described them as the "enemy" (1925, 191). Furthermore, the party's political monopoly tempted the Bolsheviks to use the power of the state against such class enemies. Political tyranny clashed with economic liberty.

6. For a discussion of the superiority of private enterprise in a socialist mixed economy, see Milanovic (1981, 137–41).

7. Bukharin offered theoretical defenses of War Communism in *The ABC of Communism* and *The Economics of the Transition Period* (1920).

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Central planning of the economy proved to be much more difficult than Bukharin had imagined. He believed that the state could use price controls to plan the economy indirectly. The state-mandated prices, however, did not reflect supply and demand. Spending shifted from controlled goods (usually essentials) to uncontrolled goods (luxury items).. The NEP established a closed economy, so shortages caused by artificially low prices could not be corrected by importing goods. State monopolies set high selling prices for some goods, while state monopsonies extracted other goods at below-market prices (Bandera 1963, 272–78). Price controls conflicted with the profit incentives offered to factory managers. Factories retained one-fifth of their profits, but with price controls in place the only easy way to boost profits was to cut costs by lowering quality. Price controls also gave no incentive for a factory manager to develop new products (Bandera 1963, 271).

Although Bukharin favored a slower rate of growth than that advocated by the Left, he still believed the NEP could support fairly rapid industrialization. This commitment to industrialization conflicted with economic reality. The Bolsheviks could have pursued long-term industrialization with an increased emphasis upon agriculture. Several non-Bolshevik economists favored such a policy. Lev Shanin, for example, noted the comparative cost advantage of Soviet agriculture. The Soviet Union, he argued, should increase agricultural exports and import capital goods. P. P. Maslov argued that the country should use its surplus labor and save capital for future investment in heavy industry. N. D. Kondratiev went even further in arguing that agriculture, not industry, should be the top priority (Bideleux 1985, 100–101; Nove 1982, 130–32; Jasny 1972, 172–74).

These strategies envisioned industrialization as a long-term process, a policy unacceptable to all Bolsheviks, including Bukharin. The Bolsheviks equated socialism with industry. They also believed that industrialization was necessary to defend the country against foreign capitalists and to strengthen the proletariat against the peasantry. Yet several factors hampered further industrial expansion. The economy had recovered by 1926, and growth leveled off thereafter. The agricultural surplus financed the industrialization drive, but commercial grain production remained weak. The Bolsheviks favored industry and defense at the expense of consumer goods production, so farmers had little incentive to produce more. The state was also failing in its bid to compete with the Nepmen for the grain trade (Volin 1970, 176–83; Nove 1982, 106; 1983, 193; [1962] 1964, 2, 22–23).

Bukharin realized that further industrialization required greater resources for industry, and therefore he called for increased regulation and taxation of Nepmen, declaring that the state must "tear the mask from the private middleman, as if from a robber, exposing him economically and

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building up our own trade" ([1926] 1982g, 132). Beginning in 1926, the party redoubled its efforts to "squeeze out" the Nepmen by increasing their taxes, cutting off their credit and supplies, and introducing "administrative measures" (arbitrary fines and arrests). Nepmen responded by forming "closed circles" with farmers, excluding the state from a portion of the grain trade, but by the years 1927 to 1928 Nepmen handled only 22 percent of retail trade and by 1929 they had been eliminated (Ball 1987, 58, 68–73, 140–43, 162–63; Bandera 1963, 269).

The state now controlled the grain trade, but its price controls led to a grain crisis from 1927 through 1928. Demand outpaced supply, and prices should have increased, but the prices for both industrial goods and grain were set below market value. Low industrial prices created a "goods famine." Consumer goods did not reach the countryside because workers near the factories bought up all the production. Meanwhile, low grain prices, coupled with high taxes, discouraged commercial grain production. Kulaks sold their surplus grain to the few remaining Nepmen or concentrated on livestock. Once again, urban food supplies were threatened (Nove 1982, 138–58).

Bukharin favored raising prices in order to increase grain production. But Josef Stalin took advantage of the crisis to consolidate his power and remove Bukharin as a potential rival. In 1927 Stalin had sided with Bukharin in expelling the Trotskyite Left from the Party. Stalin now adopted the Left's policies and turned on Bukharin and the Right Opposition (pro-NEP members on the Politburo, including Alexis Rykov and M. P. Tomskii). Stalin accused the Right of favoring the kulak and of opposing industrialization and collectivization. Fearing peasant rebellion, Bukharin opposed Stalin's plans for forced collectivization, but he had no base of support with which to challenge Stalin (Bukharin [1928] 1988d, 207; [1928] 1988b, 211; [1928] 1988a, 207). The outcome was predictable: In April 1929 Stalin declared Bukharin a "Right deviationist," and in November Bukharin was ousted from the Politburo (Stalin had him shot in 1938). Stalin ended the *smychka* and the NEP by launching a war against the peasantry (Cohen 1973, 233, 322–28; Stalin [1929] 1988, 219).

Bukharin's Legacy

Despite the demise of the NEP, Bukharin's economic thought later influenced many communist reformers and Western scholars, who considered him the "father of market socialism"—market socialism is the theory that plan and market can coexist in a socialist economy (Tarbuck 1994, 93). In the 1970s, the historian Moshe Lewin praised Bukharin's commitment to "scientific economic management" and market mechanisms (Lewin 1974,

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49, 59). Bukharin's biographer, Stephen F. Cohen, also advocated the "Bukharin alternative," which Cohen defined as "market socialism, balanced economic planning and growth, evolutionary development, civil peace, a mixed agricultural sector, and tolerance of social and cultural pluralism within the framework of the one-party state" (Cohen 1973, 384).

Actually, Bukharin never advocated the establishment of a permanent NEP, with its capitalist elements. Like Lenin, Bukharin considered the NEP a strategic retreat and a mere transition to a planned economy. The Soviet Union would use the market to "grow into socialism," and the private sector would then disappear (Bukharin [1927] 1982e, 260; [1925] 1982a, 191; [1926] 1982g, 141). He rejected the theory that capitalism and socialism could permanently coexist in an economy ([1929] 1982f, 350). Still, Bukharin's ideas do reflect some of the problems faced by market socialists. Market socialists believe that planners can simulate market signals such as prices, wages, and profits (Milton Friedman calls this simulation "playing at capitalism"). Prices would reflect the marginal cost of production; wages would rise with increases in productivity. Bukharin insisted that plan and market must complement each other and that planning should take market signals into consideration (Lewin 1974, 91).

Bukharin was extraordinarily vague when it came to offering substitutes for the market mechanisms of capitalism. The central component of market socialism is pricing policy, but Bukharin failed to describe how a planner would acquire the information required to calculate market prices. In a free market, information is dispersed among consumers, producers, and workers, and price and wage values are discovered through competition. No one individual can ascertain all consumer preferences (Hayek 1984a, 258; 1984c, 54–55; Prybyla 1987, 7). Bukharin also wrote of the necessity of "forecasting what is spontaneous and unpredictable," but never explained how to do this ([1928] 1982d, 307). He defined prices as the demand of the masses for goods, wages as "human labor" ([1929] 1982f, 349). Bukharin recognized the dangers of the "state super-monopoly" yet insisted that the party's drive to meet "the needs of the masses" could replace the profit motive ([1926] 1988c, 192). Likewise, he believed that "the necessity of satisfying the needs of the masses," not competition, drove the managers of state monopolies ([1926] 1982c, 173).

The greatest defect in Bukharin's economic theory, and in market socialism generally, was the absence of private property. Property rights spur innovation and risk-taking because a property owner is willing to gamble on an enterprise despite risks. However, in a socialist economy the government must own the capital to ensure "social justice" (i.e., redistribution of income, job security), and there is no incentive for entrepreneurship. Bureaucratic planners hesitate to finance new ideas. Propertyless managers prefer

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not to risk capital, because if they succeed the rewards are low and if they fail the losses are great. In short, real markets require private property (Hayek 1984b, 122–23; Friedman 1987, 25–29; Nutter 1968, 141–45).

Despite these problems, market socialism appealed to communist reformers trying to overcome the problems inherent in the Stalinist economic system. In a Stalinist economy, production targets are based on gross output, and product quality is ignored. Factory managers misinform planners in order to be assigned lower targets (the "ratchet effect"). Central planners neglect technological innovation. Because incompetent workers cannot be fired, hidden unemployment is high (Prybyla 1987, 25–41).

After World War II, Yugoslavia and Hungary experimented with market socialism, attempting to avoid some of these problems. In 1949 Yugoslavia established a "labor-managed market economy" in which worker-controlled enterprises produced and exchanged goods. The Yugoslavian experiment initially seemed to succeed. The country enjoyed a competitive consumer goods sector and experienced a high rate of growth in the 1960s and 1970s. Yet there was no real symbiosis between plan and market. Central planners still set prices, and the government was reluctant to finance new firms. Furthermore, no real markets existed for labor, capital, or natural resources. Worker councils limited hiring because their members did not want to reduce their share of the profits by allowing new workers into the enterprise. Workers also voted themselves excessive pay raises, causing wage increases to outpace productivity improvement. During the 1980s the economy stagnated, and inflation averaged from 50 percent to 60 percent per year. Real income declined, and unemployment increased (Prybyla 1987, 91, 245–56; Halm 1969, 83–89).

Hungarian market socialism had somewhat more success. During the 1960s, Hungarian economists revived the NEP concept of a mixed economy, and the government responded by introducing its "New Economic Mechanism." The Hungarians replaced central planning with exchanges between producers and consumers. Planners set broad targets and granted enterprises greater autonomy. The state increased investment in agriculture and encouraged the development of private plots. Hungarian planners tried to overcome the pricing problem by basing their producer prices on the world market.

The reforms produced some favorable results. Agricultural exports increased, and the consumer goods sector was more competitive than in other socialist countries. Overall, however, the results were disappointing: Hungary's measured growth rate showed only a modest improvement over that reported by the USSR. The world market did not really drive changes in Hungarian prices. State enterprises did not really compete, and the government continued to subsidize incompetent firms in order to ensure full

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employment (Szamuely 1974, 109; Bleaney 1988, 111–13; Prybyla 1987, 214–45; Sirc 1989, 226–31).[8]

The "Bukharin alternative" also influenced economic reformers in the Soviet Union. In the mid-1960s, Soviet economists (again referred to as "Nepmen") revived the NEP model. In 1965, reformers, led by Evsei Liberman, were allowed to experiment with some NEP-like policies. Profit and sales criteria replaced gross output targets, and enterprises were given greater autonomy. They could charge higher prices on new products and reinvest part of the profits. The overall targets remained, however, and the government taxed the successful enterprises more heavily than inefficient ones. Managers charged higher prices but did not improve quality or productivity (Desai 1989, 44–46; Lewin 1974, 313).

During the 1970s the Soviet government rejected the NEP model and the concept of market socialism (Dmitrenko 1972, 214). Soviet economists turned to "planometrics," attempting to use mathematical models to achieve "perfect" central planning. As before, however, information was manipulated from below (Prybyla 1987, 6), and in the early 1980s, the NEP was again touted as an alternative model for developing nations (Sochor 1982, 197–209).

The NEP model enjoyed its greatest renaissance in the Gorbachev era. When Mikhail Gorbachev came to power in 1985 he inherited a stagnant economy. His economic adviser, Abel Aganbegyan, estimated that real growth had stopped in 1978 (Åslund 1989, 15). Shortages of consumer goods, poor quality industrial goods, backward technology, a bloated bureaucracy, overcentralization, and overplanning plagued the economy (Aganbegyan 1987, 89–94; Shmelyov [1988] 1989, 78–84). Incentives were lacking, and the work ethic was practically nonexistent (Leites 1984, vii–x). The Soviet Union had evolved into a kleptocracy with rampant bribery and corruption. Entrepreneurial energies went into the illegal "second economy" (Grossman 1981, 72–88; Wiles 1989).

Gorbachev couched his economic reforms in socialist phraseology and depicted his perestroika (restructuring) as a return to NEP-like policies, which he equated with market socialism. Perestroika, like the NEP, would save socialism (Gorbachev 1987; [1987] 1988, 33, 128). Bukharin was rehabilitated, and the Soviet press published a number of articles depicting him in a positive light (Boettke [1990] 1994; "Bukharin" 1988; "Taking a Closer Look" 1988, 6; "Shatrov" 1988, 10–12). Soviet reformers uncritically

8. Jan Winiecki argues for "the increasing similarity of the STE's [Soviet-Type Economies] industrial structure," noting that "the industrial structure is not only increasingly similar, but tends to be identical in all STEs over time. Whatever differences existed in 1980, they were the residuals of the much larger differences that the East European countries displayed before adopting the system of central planning" (1988, 111).

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praised the NEP, presenting a "new rose-coloured perestroika edition" of the 1920s (Nove 1992, 241–42; Davies 1991, 118–34; Shapiro 1991, 151). Economist Vasily Selyunin described the NEP years as a period of economic growth, democratization, and positive change from above (Selyunin [1988] 1989, 20–23). Historian V. Sorotkin called the NEP "a new twist to Marxism." According to Sorotkin, the NEP was more than a retreat; it exemplified a convergence between capitalism and socialism. Sorotkin believed that if the Soviet Union had continued on the NEP path, it would have arrived at something like modern welfare capitalism (Sorotkin 1989, 6–7).[9]

Gorbachev's early reforms were designed to shift the economy toward market socialism. He revived Lenin's idea of a "tax in kind" and allowed collective farmers to sell their surplus on a "socialist market." Gorbachev also introduced family farms: families could lease land and contract with cooperatives to produce crops with the greatest potential for profit. These family farms resembled private plots, but the farmers could not buy their supplies on a free market; they remained dependent on collectives, which continued to restrict their autonomy (Tarasulo 1989, 127–29; Åslund 1989, 29; Desai 1989, 35–40).

Perestroika also involved a restructuring of industry and trade. The Law on State Enterprise (1988) partially decentralized industry. State enterprises were allowed to sell their goods on the market after meeting their state quota. Successful enterprises could reinvest part of their profits, but most of their earnings went into projects determined by central planners (Tarasulo 1989, 71; Desai 1989, 32–34). Some small steps were taken in establishing a quasi-private sector. The Law on Individual Labor Activity (1987) legalized some forms of self-employment (e.g., taxi driving, carpentry, and restaurants). The government also authorized a new type of cooperative that could engage in almost any type of economic activity. These co-ops charged higher prices than their state competitors and produced higher-quality products. Nevertheless, the cooperatives employed only a small proportion of the labor force; they were capitalist drops in a socialist sea. Also, the co-ops remained dependent on the socialist sector; they contracted with state firms and had to meet state orders. Furthermore, because the state still set prices, no real market freedom existed (Desai 1989, 39–40, 58; Tarasulo 1989, 72–73; Joffe 1989, 279).[10]

9. The convergence theory gained new adherents in the Soviet Union (Simonyan 1989, 7–9), but some Soviet scholars attacked the idealistic depictions of the NEP (Volkogonov [1987] 1989; Kozlov 1988–89).

10. The co-ops were unpopular with many Soviet citizens, who complained of higher prices and the above-average incomes earned by co-op members (Jones and Moskoff 1991, 131; "Capitalism or Socialism?" [1989] 1992, 212–24). For a first-hand account of the difficulties these "New Soviet Businessmen" faced, see Lyonhardt and Howells (1991, 29–39).

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As Gorbachev's early reforms failed to produce results, the economy continued to deteriorate. His reforms did not create real markets; they were tentative steps toward market socialism, a policy that could not cure the ills of the Soviet economy. In 1990, Gorbachev went one step further by approving legislation legalizing the ownership of private property and the hiring of labor. Yet he was "paralyzed by indecision" (Walker 1993, 208). Peter Boettke (1995) notes that "the regime kept introducing liberalization policies only to go back on them." Gorbachev's constant "zigging and zagging" undermined the credibility of his reforms (264). Gorbachev was retreating from socialism, but he never surrendered to capitalism. He repeatedly proclaimed that "I am a Communist, a convinced Communist. For some, [communism] may be a fantasy, but for me it's my main goal, which is still far away." As late as 1991, he reiterated that "I am not ashamed to admit that I am a Communist, and will be one when I go to another world" (Mikheyev 1992, 47).

Gorbachev's fall from power in 1991 paved the way for more radical reforms. His successor, Boris Yeltsin, surrounded himself with "radical procapitalist economists" (Davies 1991, 134). Yeltsin's goal was to create a "normal" (market capitalist) economy (quoted in Yeltsin 1994, 146; see also Boettke 1993, 138).[11] The road away from serfdom has been fraught with difficulties. Nevertheless, Yeltsin's ascent to power marked the apparent end of Bukharin's legacy. Having broken with communist ideology, Yeltsin "had no further use for Bukharin or the Communist legitimacy he had provided" (Gluckstein 1994, 2). Yeltsin moved beyond Bukharin, NEP, and market socialism. The ghost of Bukharin no longer haunts the Kremlin; it has been replaced by the spirit of Adam Smith.

11. Yelstin underwent a conversion to capitalism after visiting the United States in 1989. On 11 September, 1989, speaking before a Columbia University audience, he declared that "I've seen that capitalism is flourishing.... Even some of what in the United States are called slums would pass for decent housing in the Soviet Union. My views have been turned around by one hundred and eighty degrees" (Mikheyev 1992, 146).

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CAMEO

The Ambitious, Accommodative Adam Smith

SALIM RASHID

If the cause of liberty needs saints to be made palatable, then the arguments for liberty may be in deep trouble. Unmindful of this point, biographies of Adam Smith suggest that any attack on the saintliness of Smith's character sullies the case for economic liberty. (The writings of the late Murray Rothbard are an honorable exception.)[1] Having long believed that the case for freedom of trade has little to do with *The Wealth of Nations* (Rashid 1990, 1992a), I present here a quite different view of Smith. I maintain that Smith was "street-smart"; that he was a radical; that he manipulated the establishment for his own advancement; and that his strategy succeeded largely because by 1776 the intellectual struggle for free trade had already been won. Smith only shot the wounded after the battle.

Friends in High Places

Believing in the principle that one's first acquaintance with someone should be favorable, I always advise my students to begin learning about Adam Smith by reading E. G. West's *Adam Smith* (1976) or, if they can get it, Francis Hirst's *Adam Smith* (1904). However, a great deal more can be said about Smith that is relevant to an evaluation of the nature of *The Wealth of Nations* and its reception.

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1. Editor's Note: Rothbard's two-volume work on the history of economic thought was reviewed by Paul Heyne in the Fall 1996 issue of *The Independent Review*.

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Smith's practical political savvy is the least appreciated part of his character. He took care to introduce himself to, and stay in the good graces of, the political elite, such as Duke Archibald, who was often called the King of Scotland because of his power. The ceremonious openings and closings of Smith's letters to the elite clearly suggest the relationship of client to patron (Rae [1895] 1965, 103, 341). The postscript of a letter from David Hume indicates the importance of such links. Apparently Smith had been touched by accusations of heresy, perhaps because of his friendship with Hume, who wrote back confidently: "P.S. Lord Milton can with his finger stop the foul mouths of all the Roarers against heresy" (Rae [1895] 1965, 133).

Smith's practical abilities were widely appreciated at the University of Glasgow, where he was a professor from 1751 to 1763. College records show that he was a valued member of committees and was even sent to London in 1761 to transact business for the college (Rae [1895] 1965, 153). Later he carefully and capably handled his bureaucratic duties in the customs office. One way to reconcile these facts with the traditional portrayal of an archetypal absentminded professor is by assuming that Smith possessed a power of enormous concentration that enabled him to handle very competently such practical affairs as he thought necessary to deal with, but that this work was always an effort.

As Smith's airs of vacancy were both characteristic and well known from his Glasgow days, it is hard to believe that he would have been seen as a suitable tutor to young men or that Charles Townshend, a leading member of Pparlaiment, would not have been put off by such a reputation, unless Smith took special pains to soften this image. The extant correspondence does suggest that Smith was particular about his aristocratic pupils. W. R. Scott (1937, 317) was confident that Smith wrote the manuscript known as the Early Draft of *The Wealth of Nations* specifically to remind Townshend of his suitableness as tutor to the young duke of Buccleuch.

Smith's membership in various clubs served to keep him in touch with a Who's Who of Scottish life.

> The [Select] Society was established and met with the most rapid and remarkable success. The fifteen original members soon grew to a hundred and thirty, and men of the highest rank as well as literary name flocked to join it. Kames and Monboddo, Robertson and Ferguson and Hume, Carlyle and John Home, Blair and Wilkie and Wallace, the statistician; Islay Campbell and Thomas Miller, the future heads of the Court of Session; the Earls of Sutherland, Hopetoun, Marchmont, Morton, Rosebery, Erroll, Aboyne, Cassilis, Selkirk, Glasgow, and Lauderdale, Lords Elibank, Garlies, Gray, Auchinleck, and Hailes; John Adam, the architect, Dr.

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> Cullen, John Coutts, the banker and member for the city; Charles Townshend, the witty statesman; and a throng of all that was distinguished in the country, were enrolled as members. (Rae [1895] 1965, 108)

Smith also touched all the right bases during his stay in France. He "went more into society in the few months he resided in Paris than at any other period of his life. He was a regular guest in almost all of the famous literary salons of that time—Baron d'Holbach's, Helvetius', Mademoiselle l'Espinasse's, and probably Madame Necker's" (Rae [1895] 1965, 197).

Smith was always cautious about his political connections. He appreciated eighteenth-century realities and looked before he leaped. In writing the Early Draft of *The Wealth of Nations* to impress Charles Townshend, Smith was undoubtedly aware of the lucrative potential of an appointment as tutor. Even with the ample pension from the Buccleuch tutorship, Smith seemed concerned about the rivalry of Sir James Steuart as adviser to the East India Company in 1772. Whatever he may have written about the serenity of true philosophy, he was not indifferent to being in control of influence. Nor was such influence to be idly held.

> What rendered the integration of the educated classes of Scotland into the British state system so complete in the late eighteenth century was the way in which the intellectual and spiritual influence of a limited number of outstanding Scottish publicists was supplemented by solid career opportunities for many more North Britons. To the bachelor Adam Smith his access to the great and powerful such as Dundas was clearly useful mainly as a means of securing small favours, often for colleagues or acquaintances or indeed for their wives and families after the decease of their bread-winner. (Lenman 1981, 90)

It would be wrong to single out Smith. He belonged to a mutual support club in which everyone tried to do the best for himself and his group.

> Starving in a garret for the sake of Art or Truth was not a lifestyle admired by the Scottish intellectuals of this period. They all tried to make money. By his own standards Robertson made a great deal....The Scots literati tended to operate on two different, but not contradictory levels. Their material they deliberately tried to make as universal as possible, but in the manoeuvres which presented them with the crucial opportunities to seize Fame and Fortune they took it for granted they would be supported by a phalanx of fellow-Scots. (Lenman 1981, 39)

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Smith's involvement in politics was neither marginal nor ineffective. Strange as it may sound, in today's parlance he would have been called "street-smart." He was considered a good judge of what would sell (Rae [1895] 1965, 76). He kept in touch with the leading journal of the day, the *Monthly Review*, which had favorably reviewed his *Theory of Moral Sentiments.* For example, he wrote: "Remember me likewise to Mr. Griffiths. I am greatly obliged to him for the very handsom character he gave of my book in his review" (Rae [1895] 1965, 150). Whether Smith knew the editor before the review appeared is not known. The *Monthly* was the organ of the dissenters, so Smith's connection with it tells us that for all the care he took to cultivate the elite, he favored unorthodox politics. It is quite likely that he quietly contributed some pieces to the radical journals, perhaps to the *Monthly.*

Smith's advice on the conduct of the war with the American colonies, in an unsigned memorandum to Alexander Wedderburn, the solicitor-general, not only focused on the "ulcerated minds of the Americans" but seriously proposed a Machiavellian policy of deception.

> An apparent restoration of the old system, so contrived as to lead necessarily, but insensibly to the total dismemberment of America, might, perhaps, satisfy both the people of Great Britain and the leading men of America; the former mistaking, and the latter understanding the meaning of the scheme. It might, at the same time, gradually bring about an event which, in the present distressful situation of our affairs, is, perhaps, of all those which are likely to happen, the most advantageous to the state. But the policy, the secrecy, the prudence necessary for conducting a scheme of this kind, are such as, I apprehend, a British Government, from the nature and essence of our constitution, is altogether incapable of. (quoted in Guttridge 1933, 719)

Smith also suggested that the Americans be scared back to loyalty by returning Canada to the French and the Floridas to Spain, thus surrounding the colonists with enemies. Samuel Johnson had advanced the same idea in *Taxation No Tyranny* as a "wild proposal." It is one thing to present such statements in a public pamphlet as a wild proposal and quite another to write them in confidential government memoranda. On the whole, it would be best if supporters of Smith could find reasons for denying his authorship of this unsigned document.

Smith's inclinations toward political scheming also manifested themselves in his desire to "manage" merchants during the Irish Free-Trade agitation. In a strange letter of 1779, he wrote:

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> Whatever the Irish mean to demand in this way, in the present situation of our affairs I should think it madness not to grant it. Whatever they may demand, our manufacturers, unless the leading and principal men among them are properly dealt with beforehand, will probably oppose it. That they may be so dealt with I know from experience, and that it may be done at little expense and with no great trouble. I could even point to some persons who, I think, are fit and likely to deal with them successfully for this purpose. I shall not say more upon this till I see you, which I shall do the first moment I can get out of this Town. (quoted in Rae [1895] 1965, 355)

R. H. Campbell and A. S. Skinner (1982) view this extraordinary letter as showing "that Smith was not an academic recluse, giving advice without recognising the difficulties of its implementation" (209). This assessment is a rather generous dumping of sand on an unexploded grenade. Smith was not just pointing out practical difficulties; he was offering to provide practical guidance on how to remove them. Nor was this advice given to a fellow academic, signifying an idle boast, but to the mighty Dundas, soon to be practically the prime minister for Scotland. What *did* Smith mean when he said that he knew "from experience" that such management could be done "at little expense and with no great trouble"? And is this the same man who wrote that the policy of trade retaliation did not belong to the legislator but to "that insidious and crafty animal, vulgarly called a statesman or politician" (Smith [1776] 1987, 468)?

Smith was loyal to his friends. He was benign, pleasant, and generous to many people. But he was also eccentric, jealous, calculating, a trifle obsequious, and willing to resort to manipulation.

A Radical?

The approach adopted in *The Wealth of Nations* attracts many readers because of its close link with natural-rights arguments and political radicalism. The fact that Smith identified human labor as the primary source of wealth no doubt fostered this link. Many have noted Smith's sympathy for laborers and farm workers and his hostility toward masters and landlords. Combined with the general emphasis on liberty—recall the radical stress on liberty of his old teacher, Francis Hutcheson—the ideas would appear to have been a powerful solvent of traditional ideas, especially in Europe, as appreciated by such commentators as Charles Ganilh and Adolphe Blanqui.

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> Wealth, produced by labour—restores man to his primitive dignity, through the sentiment of his independence, through his obedience to laws common to all, and his sharing in the benefits of society in proportion to his services. (Ganilh [1812] 1966, 46)

> There were no longer any sterile occupations, since every body was capable of giving things an exchange value, by means of labor. What an encouragement to men ill-favored by fortune and to those who did not expect the boon of an inheritance! (Blanqui 1880, 386)

John Rae provided a perceptive statement of the political impact of free trade ideas in the 1790s:

> By French principles the public understood, it is true, much more than the abolition of all commercial and agrarian privilege which was advocated by Smith, but in their recoil they made no fine distinctions, and they naturally felt their prejudices strongly confirmed when they found men like the Marquis of Lansdowne, who were believers in the so-called French principles and believers at the same time in the principles of Adam Smith, declaring that the two things were substantially the same. (Rae [1895] 1965, 292)

Nor should this affinity entirely surprise us. That Smith had a partiality for radicalism is evidenced by his admiration of Rousseau and Voltaire. "Voltaire," Smith wrote,

> set himself to correct the vices and follies of mankind by laughing at them, and sometimes by treating them with severity, but Rousseau conducts the reader to reason and truth by the attractions of sentiment and the force of conviction. His Social Compact will one day avenge all the persecutions he suffered. (quoted in Rae [1895] 1965, 372).

James Beattie, a professor of moral philosophy at Aberdeen, criticized David Hume's skepticism as displayed in his *Essay on Truth* and later wrote to Lady Wortley Montagu that even though he had known Hume's close friend Smith well once, after the publication of the *Essay on Truth*, "nous avons changez tout cela."[2] Insofar as the movement toward a philosophic basis for free trade had sociopolitical origins, Smith's case supports Leo Rogin's thesis that "new systems first emerge in the guise of arguments in the context of social reform" (Rogin 1950, xiii).

2. "We have changed all of that." Beattie's letter is in the Huntington Library in California. For Smith's continued serviceability to radical causes, see Thompson (1984) and Stafford (1987).

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The link between natural-rights economics and political radicalism would have been evident to contemporaries. Perhaps it explains the fact that the first parliamentary reference to *The Wealth of Nations*—a reference that helped to bolster sales considerably (Rashid 1992c)—was made by Charles James Fox, the leader of the radical Whigs, who was otherwise ignorant of economics. Most of the early references to *The Wealth of Nations* in Parliament were by Whig-Radicals (Willis 1979). Smith's claim that labor was the primary source of value was picked up not only by French liberals but also by several radicals in England and served as the inspiration for most of the misnamed "Ricardian socialists" as well as for Karl Marx.

Why would the conservatives bother with such a radical author? Did they not play with fire by sanctifying his name?

To unravel this mystery, we must probe other aspects of Smith's personality. Although he was probably a Whig-Radical, he was a very deferential one. His was not simply a case of going along with existing prejudices in order to accomplish his own ends. It was more a case of willful and public support for ideas or institutions at odds with his spoken or written opinions. Consider Smith's uniformly deferential tone in his letters to his social superiors, the eagerness with which he sought public office, the unseemly diligence with which he tried to enforce customs laws, the absence of any efforts on his part to reform the system from within, and his steady use of patronage when possible. Even Smith's strong language against merchants tells against him. If he really aimed to support some notable political reform, why would he choose to bash the socially deprived class of merchants? As Lord Cockburn (1856, 170) makes clear, the landlords held all the real power, and Smith took care to avoid offending them.

In the wider sweep of British economic thought, the liberty of trade conformed entirely with traditional ideas, such as the sanctity of property and the beneficence of the existing social order. Traditional policy had long since adopted, on pragmatic grounds, a policy of noninterference in trade, manifested in the philosophy of the common law, in the decisions of the law courts, and in the policies of Smith's predecessors.[3] The common law deserves emphasis, especially as some descriptions of its growth have a very Hayekian ring. The words of Sir John Davies in 1612 are striking:

> For a Custome taketh beginning and groweth to perfection in this manner: When a reasonable act once done is found to be good and beneficiall to the people, and agreeable to their nature and

3. The following paragraphs draw on my "The Pragmatic Imagery of Free Trade," Working Paper, Department of Economics, University of Illinois, 1991. A revised version of this paper is forthcoming in *Research in the History of Economic Thought and Methodology.*

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> disposition, then do they use it and practise it again and again, and so by often iteration and multiplication of the act it becometh a *Custome*; and being continued without interruption time out of mind, it obtaineth the force of a *Law*. (quoted in Pocock 1957, 112)

William Blackstone's authoritative summary of English rights in his *Commentaries* uses somber language, but the practical import is much the same: "The rights of the people of England...may be reduced to three principal or primary articles; the right of personal security, the right of personal liberty, and the right of private property" ([1765–69] 1973, 62). The adoption of non-interference as a general guide by the judges is adequately documented by Eli Heckscher ([1935] 1955).

Adam Anderson wrote the *Historical and Chronological Deduction of the Origin of Commerce*, a work utilized by the younger Pitt. Anderson had less patience with usury laws than Smith: "We have seen the blind zeal of a Parliament of 1552, in their law against usury, or the use of interest for money.... But our legislators were now become more enlightened" (Anderson [1801] 1967, 2:135). On the sensitive policy question of the corn trade, Anderson took almost as strong a stand as Smith by calling a proclamation of 1630 against engrossers and buyers of corn "a more extraordinary proclamation" (137). It is no surprise that Anderson adumbrated notions attributed to Smith regarding the prosperity of Britain as consequent upon political stability and the security of property.

In *The Interest of Scotland Considered* (1733), Patrick Lindesay argued strongly that the Scots should concentrate on linen and consider other manufactures as subsidiary. Although Lindesay's efforts to encourage the linen industry may well have had practical effect, the interesting point for us is the manner in which he states that economic growth is "natural" under a free and equitable government: "[N]o Commonwealth can flourish, but where every Individual finds his Account in his own Business; and by promoting his own Interest, he so far advances that of the Publick" (41). Lindesay came close to introducing the invisible hand:

> The best Patriotism, in private Life, is to be diligent and regular in our Application to Business, and frugal in the Management of our private Affairs: And so far every one acts the Part of a Patriot, as he promotes and advances his own Interest and Prosperity, he thereby contributes towards the Advancement of the Interest of the Publick, which consists of, and comprehends the Whole. (46)

Against this background, it is clear that Smith's views only reinforced traditional views about the sanctity of property and the liberty of trade.

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Go with the Flow

Smith rose to prominence when he was repeatedly cited in the debates over public policy during scarcities. Here Smith's policy was strict laissez faire. The policy of leaving the market for food alone had been accepted by a substantial number of British economists. Arthur Young in particular had vociferously urged the abolition of all restraining laws in the market for grain. Nonetheless, the policy was dangerously unpopular with the poor (Rashid 1980).

Smith began by assuring readers that the interests of the consumer and the seller are identical: "The interest of the inland dealer, and that of the great body of the people, how opposite soever they may at first sight appear, are, even in years of the greatest scarcity, exactly the same" (Smith [1776] 1987, 524). He admitted that if a monopoly could be formed, it *might* be harmful to the public, but he scoffed at such a possibility: "It is scarce possible, even by the violence of law, to establish...an extensive monopoly with regard to corn" (525). Indeed, if a famine were to occur, Smith was sure it was because the government had attempted to regulate that which was properly left free: "[In Europe] a famine has never arisen from any other cause but the violence of government attempting by improper means, to remedy the inconveniences of a dearth" (526). "The unlimited, unrestrained freedom of the corn trade, as it is the only effectual preventitive of the miseries of a famine, so it is the best palliative of the inconveniences of a dearth" (527). How could the conservatives resist this closely reasoned defense of the traditional order when someone of radical sympathies provided it?

In economic matters, the dominant opinion between 1790 and 1830 undoubtedly supported property, that is, it was conservative. Despite the radicalism of his personal sympathies, Smith tailored his views and his life to be acceptable to the established order. There is little surprise in finding that this cultivation bore fruit and that Smith's ideas proved serviceable in the defense of conservatism. One must admire Smith's acumen and strategy in utilizing the existing order to achieve immortality.

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COMMENT

Wreaking Hobbes on Mankind

PHILIP COATES

For a long time I've wondered why so many intelligent, worthy people remain darkly skeptical of arguments for more freedom and less government. They shake their heads and smile that world-weary you're-so-naïve smile, not focusing on the details of the argument. Some are conservatives who have fought doggedly for much of their lives to hold the line against government. They do not appear anxious to escape from the room because they can't respond, but evidently giving an adequate answer would take far too long—they know something deeper than political philosophy. "Well," they say with resignation, "I believed that sort of utopian thing when I was younger, but I've seen a lot more of the world since then." Sometimes they project a wistfulness or sadness that significantly less government is unworkable. One leaves such discussions feeling that if one can't reach these people, convincing the wider world of the merits of a freer society will be difficult indeed.

"What Is Living and What Is Dead in Classical Liberalism?" by Charles K. Rowley (1996) helps fill in a piece of the puzzle. It reveals a key factor that may have contributed to the retreat from classical liberalism by two prominent and influential academics, John Gray and Robert Nozick. It is often difficult to trace the intellectual roots of a thinker's ideas—roots by nature lie under the surface. But Rowley suggests that, at least for Gray, one

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factor is a highly negative view of man, specifically, the view of human nature of British philosopher Thomas Hobbes. When debating about government, it may be necessary to go beneath political philosophy to delve into more fundamental areas of general philosophy and psychology. Rowley indicates that Gray shares the conclusion of Hobbesian psychology: free men are self-destructive creatures destined for a "war of all against all." Gray then accepts Hobbes's political conclusion that freedom must be sacrificed to maintain peace and order. He then argues that a broad spectrum of societies—from Asian authoritarianisms to some welfare states and liberal democracies—might be compatible with the maintenance of peace and order.

But if Gray does hold a consistently Hobbesian view of man, his conclusion is too ecumenical and flexible. He must not accept *any* nonauthoritarian societies. After all, Hobbes viewed men as incapable of composing a responsible society in which people respect the rights of others. For the most part, he maintained, either greed or laziness ("covetousness" and "sloth") motivates men. Moreover, they naturally follow their feelings, their lust for riches and power, regardless of the means required to achieve their objectives; and this passionate irrationality leads to war. If this view of man as either universally or primarily an unreasoning brute is accepted, how can one logically advocate anything but authoritarianism? After all, freedom must lead ultimately to anarchy and chaos.

Hobbesian Psychology

What deeper view of human psychology supports such conclusions? For Hobbes, "the passions" motivate people. Why? Because objects produce in men "appetites and aversions" associated with pleasure and pain; and man is a volitionless machine. So the last desire before an action determines it. "In deliberation, the last appetite or aversion immediately adhering to the action or to the omission thereof, is that we call the Will" (Hobbes [1651] 1994, chap. 6, par. 53). Reason is the slave of the immediate desires. Reason is impotent (Strauss 1963, 3). It cannot independently cause action. In fact, reason, or "deliberation," is actually defined in terms of the passions (Hinnant 1977, 57).

What attitudes follow? Men are fundamentally antisocial and the enemies of one another. When a man acts among others, he tends to assert himself and to seek power. Men desire that the whole world fear and obey them (Strauss 1963, 18). "But the tongue of man is a trumpet of war and sedition" (Hobbes [1642] 1983, chap. 5, par. 5). Pride, avarice, ambition, and fear of death primarily motivate men, who call good whatever pleases them for the moment. In *Elements of Law* Hobbes states that

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> Since men by natural passion are divers ways offensive one to another, every man thinking well of himself, and hating to see the same in others, they must needs provoke one another by words, and other signs of contempt and hatred which are incident to all comparison, till at last they must determine the pre-eminence by strength and force of body. (Hobbes [1640] 1969, pt. 1, chap. 14, par. 4)

What can prevent this outcome? According to Hobbes, only the fear of death. Nothing but a supreme and absolute authority to which men will submit can halt perpetual strife and suspicion. Don't bother preaching a sermon to a horse; it responds only to the whip.

The Life and Times of Hobbes

Although Hobbes himself was a materialist and a determinist—hence the metaphysical underpinning of his view of man as a volitionless machine—it is important to note the conditions in which he lived. During his lifetime England passed through a chaotic era marked by deep disputes over authority, which culminated in civil war, overthrow of the established system of government, and ongoing contention over who would hold legal power: the Great Rebellion of 1642 to 1652, the overthrow of the monarchy, the rule of Cromwell, and the restoration of the Stuarts. Battles raged continually between king and parliament, between common man and noble, between Catholic and Protestant. The age has been called a time precariously poised between anarchy and civil disorder. Moreover, external wars with various continental powers kept breaking out.

If, as commentators have argued, Hobbes's fragmented world provided the raw materials for his ideology, subsequent personal experiences must have reinforced his bleak outlook. His life and freedom chronically endangered, he endured a series of oppressions expressing the baser natures of small men. He was barred from court for his views. Later he had to flee France because some there viewed his writings as containing an attack on the papacy. He had to kowtow before being allowed to live quietly in England again. Finally, in a time of superstitious fear caused by the Plague and other calamities, he faced still more persecution as a possible atheist and heretic and was forbidden to write again on "ethical subjects."

To some the upheaval, insecurity, vying for power, and injustice of Hobbes's time may seem to confirm all too well his malignant view of humankind. In his own time one group that might have found him persuasive comprised those who saw the freedom of thought and conscience of the Renaissance and the Reformation as the cause of the prevailing anarchy. In today's world, Gray praises Hobbes for his modernist sensibility, "arresting

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contemporaneity," and "supreme relevance" (Rowley 1996, 24). Hobbes's ideas have indeed been resurrected and viewed favorably in the twentieth century in the wake of the holocaust and the world wars. This decades-long epidemic of disaster has seemed to many intellectuals to support his basic assumptions. Balefully scowling down on us, the nasty and brutish ghost of Hobbes intones: "Look at the unleashing of total war, the wholesale debasement and brutalization, the lunatic destructiveness, the piles of bodies—you who believe men are suited to live rationally and peacefully together with a minimum of restraint, without stern and inflexible control!"

Other, Better Lives and Times

But those who embrace either the politics or the psychology of this view lose sight of the rest of history. The conditions of Hobbes's time did not persist; the world improved. The English resolved their differences over the powers to vest in parliament and the monarchy. Eventually they could freely espouse their religious beliefs, speak their minds about politics, and publish their political or philosophical writings without fear of violent retribution. And these conditions have persisted for centuries.

No Hobbesian authority was needed to keep in line the Englishmen who enjoyed these liberties. Rather, the opposite direction was chosen. And religious freedom, political toleration, freedom of expression, the rule of law, and civil order have spread in tandem far beyond England. If men were the slaves of their boiling impulses and sudden rages and could not reason past them, how could this outcome have ever occurred?

The periods of power lust and religious blood feuds, of senseless conflict and chaos in Europe's and the world's history down through much of this century, demonstrate that men have the capacity to act in Hobbesian fashion. They can, on a societywide scale, put their unexamined, short-run, or baser emotions and motivations in the saddle. But other times show that humans also have the capacity to behave quite differently. These eras show that people can function on a higher level, and can do so without a chain, a leash, and a whip to induce their every action and decision. With the fall of the absolute monarchies, freedom gradually began to increase; and as it did so, the anarchic end of civilization, the "war of all against all" that Hobbes foresaw and Gray, living in better and more secure times, still fearfully echoes, never happened.

Although the direction of our era remains unsettled and our world is far from perfect (and of course the future is not guaranteed), in many ways we live in an era that rebuts Hobbes's determinism about men's motivations and actions. In fact, the times and places in which men have lived under the very sort of authoritarian government that Hobbes recommended—in

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Germany, the Soviet Union, and China—have been the most insecure, warlike, and destructive of all. As those regimes have tended either to be defeated by the armies of freer (and therefore more prosperous) nations or to melt away through their own internal destructiveness and the people's perception of their injustice, the world has begun to clear a greater space for prosperity and freedom to coexist with order and peace. The doomsday weapons now point toward the oceans; many are being dismantled. World trade and the stability it requires, offering vast new segments of the world's people a chance for productive lives and wider prosperity, have made war and the forcible seizure of others' property less attractive. People from the former communist and apartheid countries show signs of moving toward integration into a single wider civilization.

Normal Human Development

Consider a typical middle-class American man today. As a schoolchild he may have sometimes given in to his impulses to bully someone smaller or to steal someone's lunch. But he learned about the balance between emotions and reason, between "passions" or impulses and self-control or reflection, between short-range pleasures or satisfactions and long-range self-interest. When he acted in a Hobbesian (or Nietzschean) way, he was ostracized or punished, and he didn't feel good about himself. Maybe he met someone bigger who inflicted injustices on him. He became more mature, often by trying different ways of behaving and reflecting on them; not necessarily because some authority figure said "no" every step of the way. The authority figure can't always be there. (As many have observed, if people in general thought it proper or felt it attractive to steal or commit other crimes, all the police on the planet couldn't keep order in one medium-sized city.) As he grew up, he learned in other ways that focusing on the gratification of immediate passions and desires got bad results. If he didn't study and graduate at least from high school, he wouldn't earn much income and wouldn't have much of a future. When he fell in love, when he formed close friendships, he learned to care deeply about other people. He wanted then to direct many of his efforts, thoughts, and emotions toward their happiness and well-being.

Every step of this process, which occurs millions of times daily around the world, refutes Hobbes. Most men in moderately stable and sustaining cultures do not develop into power-lusters, aggressors, or enemies of all men; nor do they experience such seething impulses and attitudes internally. (Hitler and Stalin were psychopaths.) Nor are human motivations directed only toward physical possessions or consumption. They include a wide range of ends appropriate to a thinking creature whose emotions rise far above the

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level of the physical sensations of a snail or a bat. People value enjoyable work, creativity, amiable human relationships, aesthetic pleasures, and a sense of membership in a successful and beneficent community and society.

The example could be extended to discuss the man's wife and how her emotional and social maturation occurred; how one can properly have an interest in one's society, nation, and community and the lives of and justice toward people in general; and how all of this develops without any use of governmental authority to forcibly constrain human nature. But this extension is unnecessary once the point of the example is grasped.

Like history viewed broadly, a proper introspection or a glance around us at people we know shows that Hobbes was wrong about human nature. Man is not a robot driven inexorably by the emotion of the moment. He possesses both reason and emotion and must create his own balanced integration—or war and disunity—of them. Far from always responding to the most recent Pavlovian stimulus, people gradually develop a huge body of knowledge, values, and feelings, and they process each event in life in a vast context molded from these elements.

Summoning the Darkness

The debate transcends that between academics or about classical liberalism. The flawed, malevolent Hobbesian view of people, or a similar view springing from other philosophical roots, is far more widespread and subtle than the explicit or full form in which rigorous political thinkers may adopt it. People may accept the view only in part; it can seep in from religious sources; it can emerge nonphilosophically from making one's empirical observations too selectively.

One sometimes senses an apprehensive, despairing spirit that seems unjustified by the immediately surrounding facts of the age or by the evidence arrayed. Russell Kirk, the traditionalist conservative intellectual, has voiced the perched-on-the-edge-of-an-abyss sensibility often fashionable across the cultural as well as the political spectrum today:

> We live in a world that is giving at the seams. Sometimes, indeed...there comes an uneasy feeling that the garment of civilization has already parted; and that if one were to tug even the least bit, a sleeve or a trouser leg of our social fabric would come away in his hand. (Kirk 1965, 160)

Kirk wrote this passage not of collapsing Rome in the fourth century but of America in 1965, before the Vietnam War scattered intellectual shrapnel everywhere, before Watergate, before the counterculture, the New Left, or various nihilistic movements had come to the fore. One can better

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understand the bleakness of this outlook by supposing that, more than mere existential facts, the writer's entire metaphysics and his view of human capabilities led him to the edge of a dark cliff.

Of course, the nonintellectual—the man on the street who responds to arguments for reduced regulation with skepticism and a conviction that pure voluntarism can't work in the real world—has never read Hobbes. He gets his sense of humankind from "street smarts" formed from his own experiences. Many people lose their benevolence or potential for optimism in stages because of bad or disheartening experiences. They subconsciously generalize about people and what to expect of them from unfortunate relations with parents and others.

The ideas of the intellectual and those of the man on the street, even if false, can reinforce each other and have an unintended effect. In the end, like all the skeptical, cynical, and nihilist philosophies that litter the world, Hobbesianism becomes a self-fulfilling prophecy. Acting together, like opportunistic viruses in a patient with a weakened immune system, they sap energy and undercut self-confidence. They bring about results less likely to have occurred otherwise. If people act as though these doctrines are true, treating their fellows—and worse, themselves—as though they were limited, shrunken, and hopeless, they will indeed tear the fabric of civilization, opening the way for the very destruction they fear.

Conclusion

As we move toward quarantine and inoculation, Gray has unwittingly done us a service. He has underlined a view of human nature that may well explain his political mutation and the faintheartedness of others. Rowley deserves thanks for shining a light on the disease. But note that besides the purely Hobbesian misconceptions, there is a deeper error in the methods often used by intellectuals in drawing wide conclusions of the Hobbesian sort: their thinking is too shallow, and they are too quick to generalize.

If one were to offer two words of advice to Hobbes and Gray (and perhaps to Nozick if the shoe fits), they would be extrospection and introspection. Review both the external and the internal evidence more thoroughly. Look again at history, well beyond the most recent era, as a check on your political philosophy. And look inside yourself, asking whether your self-knowledge comports with your assumptions about human nature. Try to come to a fuller understanding of the psychology of mature human beings than did a beleaguered seventeenth-century deterministic British thinker who formed his views in exceptionally unsettled and violent circumstances.

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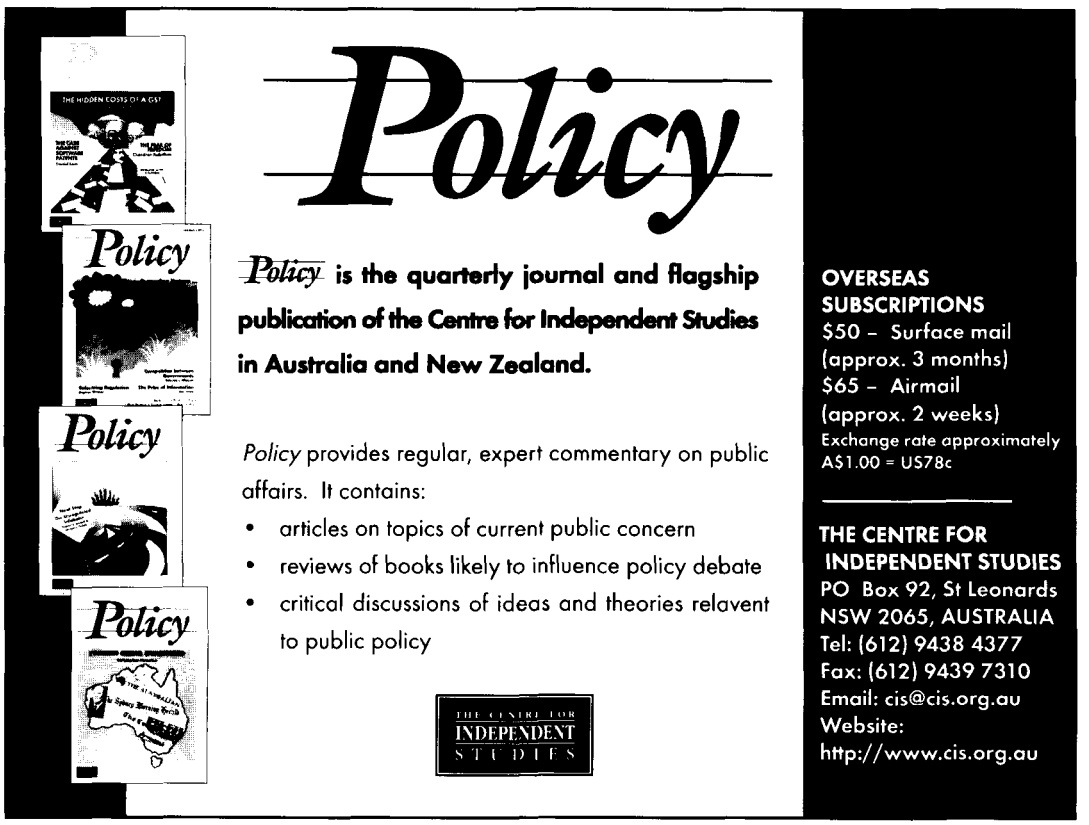
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BOOK REVIEWS

✦ Utilitarianism as a Public Philosophy

By Robert E. Goodin

New York: Cambridge University Press, 1995.
Pp. xii, 352. $18.95 paper.

Robert Goodin is a political philosopher at the Research School of Social Sciences of the Australian National University. Here he pulls together seventeen previously published articles, slightly edited. A new introduction carries the same title as the book.

Goodin tackles a great variety of questions. When is it desirable to take account of other people's motives, and one's own? How are duties and responsibilities to be distinguished? Do intentions or do results count more heavily in the ethical appraisal of actions? Is it better to satisfy whatever desires people may currently happen to have or, in case of divergence, to serve their genuine interests? Do some desires deserve less respect in public policy than others—should preferences be "laundered"? How are rewards and liabilities to be apportioned when the shares of credit or blame of the different persons responsible for some outcome add up to more or less than 100 percent? What determines whether "heroic measures" in desperate medical cases—experimental measures with slight prospects of success—are morally justified? What conceptions of "compensation" for harm or misfortune may usefully be distinguished? What philosophical considerations bear on various features of the welfare state? Is "the best way of satisfying unmet needs...to cause those who are relatively more needy to have more of the needed resource...[or] rather to cause others to have less of it"? (The latter may be correct, says Goodin; then follows a quotation from Rousseau. He

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notes, furthermore, that in some cases "the strategy of wantonly destroying the resources of the rich, Pol Pot style, might turn out to be the socially preferred strategy" [pp. 244, 249].) To weaken competition in the consumption of status goods, should Australia tax French champagne or outright ban importing it? What is the case for granting a basic income to all individuals, no questions asked? As Philippe Van Parijs put that question, what are the reasons "why surfers should be fed"? "What is so special about our fellow countrymen?" Why is unilateral nuclear disarmament morally obligatory? What international ethical considerations bear on the environmental "crisis"? (Goodin seems particularly worried about the ozone layer.)

Hypothetical cases get spun out at length, illustrating a philosophical style that seems in vogue these days. Goodin offers few new facts that relate to the issues he discusses, but he does display cleverness in mustering arguments in support of his intuitions. Some readers, including even me in a certain mood, may be charmed by these separate exercises in philosophical acumen.

More nearly central to the topic suggested by the book's title is a chapter on "The state as a moral agent," as well as scattered other passages criticizing libertarianism as Goodin understands it and urging government activism instead. Considerations that might excuse people from performing certain duties individually count for recognizing and performing those duties collectively. A coordination problem, as well as shirking by free riders, may frustrate *voluntary* collective action, thereby keeping even people who want to perform their duties from doing so. State coercion then may be justified to overcome this frustration, this impasse. The questions I have listed suggest how broad a range of activities Goodin would assign to the state.

Still closer to a central theme is Goodin's introductory chapter (and related passages elsewhere). Whatever objections may count against utilitarianism as a personal ethical philosophy, these hardly discredit utilitarianism as a philosophy for government officials. For them, dealing with aggregates and averages is appropriate. Goodin does not say, however, that public officials may properly do whatever they think likely to maximize utility on a case-by-case basis. They, like private persons, should adhere not to act utilitarianism but to a rules or indirect utilitarianism, a version concerned with principles, rules, institutions, attitudes, and even character traits.

Speaking of public officials, I wonder how familiar Goodin is with the teachings of the Public Choice school. Not very familiar, to judge from page 129. There he writes that "public officials take a longer time horizon than do individuals planning their own private lives" and that

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> Being judged by voters in the longer term and in a more general way for their superintendence of the citizenry's interests, representatives can do for the people what is truly in their interests but which they would find it psychologically difficult to do for themselves. Being ultimately democratically accountable, they would be unable to do too much that was not in the citizenry's longer-term and more general interests, otherwise they would not win reelection.

Goodin cites nothing by James Buchanan and only one of Gordon Tullock's lesser-known articles.

It is not entirely clear to me why Goodin considers utilitarianism less acceptable as a private than as a public philosophy. Neither in the private nor in the public sphere does a sound moral philosophy call for case-by-case attempts to maximize some supposed aggregate utility. Instead it emphasizes rules, principles, attitudes, and character traits. I wonder whether Goodin recognizes the distinction, urged by R. M. Hare and other philosophers, between two levels of moral philosophizing. On the applied level, people are expected to heed certain ethical precepts almost as absolutes. On the reflective level, philosophers and others in a properly detached mood assess just *what* precepts should be rejected or chosen for application in everyday life.

And what is the *grounding* of suitable precepts? This is the central question of so-called metaethics. Libertarian theorists, among others, pay much attention to it. Are ethical principles, including those invoked in policy discussions, most coherently grounded in duty in the style of Immanuel Kant, in natural or individual rights taken almost as axiomatic, in some sort of fundamental if tacit social contract, or in utility in some sense? Goodin does allude to these rival approaches, but he does not squarely discuss them and reject all but his own particular brand of utilitarianism. (He does duly recognize that utilitarianism comes in numerous varieties. I myself think that all sound arguments about public and personal policy, and especially the principles they appeal to, are *at bottom* utilitarian; yet Goodin does not show why, or even try to. I would hate to have the brand of utilitarianism that I accept associated with and judged by Goodin's discussion.)

Goodin is less concerned with grounding than with application of his own ethical notions to particular cases and policy issues. Indeed, I get the impression that his book and its title are mainly just an umbrella to cover his diverse musings. Admittedly, though, it is unfair of me to complain of Goodin's writing his own book rather than what I expected from its title when agreeing to review it.

Goodin's writing in some of the chapters is verbose and repetitious.

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Organization suffers from fragmentation of the discussion between main text and footnotes. Readers can be grateful, anyway, that the notes appear at the bottom of the individual pages rather than, inconveniently, at the ends of chapters or of the whole book.

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✦ Against the Imperial Judiciary: The Supreme Court vs. the Sovereignty of the People

By Matthew J. Franck

Lawrence: University Press of Kansas, 1996.
Pp. xvi, 256. $35.00 cloth.

The role of the Supreme Court under the United States Constitution has been a source of controversy since the framing of that document. The reason is that no provision of the Constitution accords the Supreme Court a review power over the other branches of government. Under the review power, the Court has authority to invalidate laws or regulations that it interprets as violating the Constitution. The Court has exercised this power on the basis of its interpretation of the Constitution beginning with *Marbury v. Madison,* decided in 1803.

In his scholarly book *Against the Imperial Judiciary,* Matthew J. Franck takes the position that the judiciary's interpretative authority under the Constitution is subordinate to that of the Congress. He rejects any judicial veto power over Congress. If the people believe that Congress has passed measures that violate the Constitution, they can go to the polls to change the Congress or they can amend the document to reverse the provision in question. The only other remedy, according to him, is the one contemplated in the Declaration of Independence: revolution. This is appropriate whenever a "long train of abuses and usurpations" shows the government to be destructive of the purposes of the social compact.

Franck supports his thesis by explaining that both John Locke and William Blackstone, two commentators highly regarded in the late eighteenth century, believed in legislative supremacy and accepted public voting or revolution as the only ways to remove laws that are not legitimate. Courts were not to decide what rights people possessed but to serve as arenas for resolving conflicts between individuals over these rights. The only other function for the judges was to serve an epideictic role with the "aim of keeping alive and vibrant the people's appetite for and ethic of generous republican liberty."

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In my view, Franck's interpretation of congressional power is in error. The proposed Constitution of 1787 would not have been ratified if the public believed that the Congress's powers were supreme. In framing the United States Constitution, the Constitutional Convention of 1787 rejected a fundamental principle of English government, the sovereignty of Parliament. In place of legislative supremacy the framers established a divided and limited government of three branches, each with power to monitor the others in fulfillment of constitutional terms and purposes.

Fearing legislative supremacy as hostile to freedom, the delegates to the Constitutional Convention turned down an effort to give Congress immense powers. The Committee of Detail recommended that Congress be given the sweeping power to provide "for the well managing and securing the common property and general interests and welfare of the United States," but this proposal did not appear in any drafts of the Constitution (Irving Brant, *The Fourth President: The Life and Times of James Madison.* Indianapolis: Bobbs-Merrill, 1970, p. 186).

This occurrence was not unusual. The convention refused to empower the national government to act in many areas: to set up temporary governments in new states; to grant charters of incorporation; to create seminaries for the promotion of literature and the arts; to establish public institutions, rewards, and immunities for the promotion of agriculture, commerce, trades, and manufactures; to regulate stages on the post road; to establish a university; to encourage, by proper premiums and provisions, the advancement of useful knowledge and discoveries; to provide for opening and establishing canals; to emit bills of credit (which then meant printing unbacked paper for circulation as currency); and to make sumptuary laws. Each of these proposals was introduced and was then either voted down or not considered further outside of committee. The Constitution lists the powers delegated to Congress. According to Alexander Hamilton, "there is no position which depends on clearer principles than that every act of a delegated authority, contrary to a tenor of the commission under which it is exercised, is void."

The framers' debate on whether Congress should have the power to print paper money not backed by precious metals is instructive on their meaning of enumerated authority. Because the powers to borrow money and to emit bills of credit had been granted to Congress under the Articles of Confederation, they were extended to the new government in an early draft of the Constitution prepared by the Committee of Detail. Gouverneur Morris of Pennsylvania opposed giving Congress the power to emit bills of credit, and he moved to strike the phrase authorizing it. Apparently, the delegates believed the absence of language permitting emission sufficed to deny Congress this authority. Although most delegates opposed granting

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this power, and the states voted nine to two in support of Morris's motion, no delegate sought to insert a specific ban.

The leading theoretician among the framers on the subject of separation of powers was James Madison. In replying to public concerns about excessive government powers in the proposed Constitution, Madison devoted five *Federalist* papers (numbers 47, 48, 49, 50, and 51) to discussing and explaining the Constitution's separation of powers.

The separation of powers consisted of, first, the division of functions, and second, checks and balances held by each branch with respect to the others. Responding to attacks on the proposed constitution, Madison asserted: "Were the federal constitution therefore really chargeable with this accumulation of powers or with a mixture of powers having a dangerous tendency to such an accumulation, no further arguments would be necessary to inspire universal reprobation of the system" (*Federalist* paper no. 47).

An opponent of majority rule, Madison extolled the separation principle: "No political truth is certainly of greater intrinsic value or as stamped with the authenticity of more enlightened patrons of liberty." Moreover, "the accumulation of all powers legislative, executive and judiciary in the same lands, whether of one, a few or many, and whether hereditary, self appointed, or elective, may justly be pronounced the very definition of tyranny" (*Federalist* paper no. 47). Implementation of the separation principle, Madison explained, would be accomplished not only by the legal text but also by "so contriving the interior structure of government as that its several constituent parts may, by their mutual relations, be the means of keeping each other in their proper places" (*Federalist* paper no. 51).

> But the great security against a gradual concentration of the several powers in the same department consists in giving to those who administer each department the necessary constitutional means and personal motives to resist encroachments of the others. The provision for defense must in this, as in all other cases, be made commensurate to the danger of attack. Ambition must be made to counteract ambition.... In framing a government which is to be administered by men over men, the great difficulty lies in this: you must first enable the government to control the governed; and in the next place oblige it to control itself. A dependence on the people is no doubt, the primary control on the government; but experience has taught mankind the necessity of auxiliary precautions. (*Federalist* paper no. 51)

Madison was particularly concerned about legislative excesses. "In republican government the legislative authority, necessarily, predominates" (*Federalist* paper no. 51). The legislature "was the real source of danger to

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the American Constitution [necessitating] giving every defensive authority to the other departments that was consistent with republican principles" (M. Farrand, *The Records of the Federal Convention of 1787,* rev. ed., vol. 2. New Haven: Yale University Press, 1937, p. 74). If the Congress violates the Constitution, Madison stated, "the success of the usurpation will depend on the executive and judiciary departments" and in time the electorate (*Federalist* paper no. 44).

Madison rejected majority rule as a matter of principle. "In fact, it is only re-establishing, under another name and more specious form, force as a matter of right" (*The Forging of American Federalism: Selected Writings of James Madison,* edited by Saul K. Padover. New York: Harper & Row, 1965, p. 45). Granting the legislature unlimited power, he wrote, violated a fundamental principle of a free society:

> No man is allowed to be a judge in his own cause, because his interest would certainly bias his judgment, and, not improbably, corrupt his integrity. With equal, nay with greater reason, a body of men are unfit to be both judges and parties at the same time; yet what are many of the most important acts of legislation but so many judicial determinations, not indeed concerning the rights of single persons, but concerning the rights of large bodies of citizens? And what are the different classes of legislators but advocates and parties to the causes which they determine? (*Federalist* paper no. 10.)

Others also feared majoritarian power. James Wilson, an influential framer, observed that after the destruction of royal supremacy in England, "a more pure and unmixed tyranny sprang up in the parliament than had been exercised by the monarch" (quoted in Philip B. Kurland and Ralph Lerner, *The Founders' Constitution,* vol. 1. Chicago: University of Chicago Press, 1987, p. 323). Apprehensive about lawmakers, Hamilton condemned the state legislatures for failing to safeguard commercial rights (*The Papers of Alexander Hamilton,* edited by Harold C. Syrett, vol. 25. New York: Columbia University Press, 1977, pp. 478–79). Gouverneur Morris found in every state legislative department "excesses [against] personal liberty private property [and] personal safety" (Farrand, vol. 1, p. 512), and Edmund Randolph presented the Virginia Plan to the Convention to overcome the "turbulence and follies of democracy" (Farrand, vol. 1, p. 51).

Hamilton also described the dangers an unlimited legislature posed for a society:

> Are not popular assemblies subject to the impulses of rage, resentment, jealousy, avarice, and of other irregular and violent

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> propensities? Is it not well known that their determinations are often governed by a few individuals in whom they place confidence and are, of course, liable to be tinctured by the passions and views of those individuals? (*Federalist* paper no. 6)

Only the judiciary, Hamilton reasoned, was in a position to secure the Constitution:

> The complete independence of the courts of justice is peculiarly essential in a limited constitution. By a limited constitution, I understand one which contains certain specified exceptions to the legislative authority; such, for instance, as that it shall pass no bills of attainder, no *ex post facto* laws, and the like. Limitations of this kind can be preserved in practice no other way than through the medium of the courts of justice; whose duty it must be to declare all acts contrary to the manifest tenor of the constitution void. Without this, all the reservations of particular rights or privileges would amount to nothing. (*Federalist* paper no. 78)

Hamilton declared that the judiciary would never endanger the liberty of the people "so long as the judiciary remains truly distinct from both the legislature and the executive. For I agree [with Montesquieu, the celebrated French writer] that 'there is no liberty if the power of judging be not separated from the legislative and executive powers.'" Hamilton exhibited great perception in these observations. The history of the Supreme Court has shown that its major failings occur when it seeks to exercise legislative or executive powers (see, generally, Bernard H. Siegan, *The Supreme Court's Constitution: In Inquiry Into Judicial Review and Its Impact on Society.* New Brunswick and Oxford: Transaction, 1987).

So what should we conclude about Franck's position on legislative supremacy? To be sure, Locke and Blackstone were highly regarded in the revolutionary and constitutional periods, and their writings greatly influenced learned people of those times. However, it is evident that the framers rejected the ideas of these two commentators about legislative supremacy. The Constitution created a new form of government of such modest power that its framers did not believe a Bill of Rights was required to protect the people. In the words of Alexander Hamilton, "For why declare that things shall not be done when there is no power to do?"

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✦ The Myth of American Individualism

By Barry Alan Shain

Princeton: Princeton University Press, 1994.
Pp. 394. $49.50 cloth, $17.95 paper.

Celebration of the nation's bicentennial touched off a lively reappraisal of the American founding era. From the events leading to the declaration of American independence in 1776 to the arguments over the adoption of the U.S. Constitution in 1787–88, each step in the state-building process was carefully investigated. Yet, despite a remarkable outpouring of research and three decades of debate, no agreement emerged regarding the founders' "original intent." Some progress was recorded. After the published reports of Bailyn, Pocock, and Wood, few historians could cling to the old Marxist claim that material interests and class rivalry alone had determined the historical course. But although most historians acknowledged the power of ideas and ideologies to shape the course of human events, it was still unclear exactly whose ideas and which ideology most completely captured the imagination of early America.

Wood and Pocock, in particular, raised a strong challenge to the standard account that for so long had accorded John Locke's ideas a position of preeminence in the period. Evidence of a very different ideological outlook, a "classical republican" tradition that could be traced to Aristotle and ancient Rome, appeared everywhere in the public prints of the age. Lockean liberalism extolled an ethic of private acquisitiveness, politically protected the natural and inviolate right of property, and allowed wide inequalities in the distribution of wealth, whereas the republican tradition upheld the good of the res publica, demanded public participation—even patriotic sacrifice—on its behalf, and tirelessly warned of the baleful effects of economic inequality. Seen from this latter perspective, the *individualist* proclivity invariably divided republics into insidious factions and so paved the way for political competition, corruption, and dissolution. The founders' republicanism, in short, bore witness to the *communal* spirit of '76. American patriots fought hard to preserve the public liberty of thirteen self-governing corporate bodies, not the private liberty of so many self-centered citizens.

Before long, however, this challenging revisionist viewpoint itself came under critical scrutiny. The embarrassing problem was that historians who emphasized the Lockean or liberal and those who stressed the civic or republican roots of American democracy could both point to compelling documentary evidence in support of their competing claims. The perplexing reality is that throughout the founding era, liberal commitments and republican concerns continually blended, very often within a few brief pages or

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paragraphs of the same pamphlet, sermon, or revolutionary proclamation. Thus, Jefferson's Declaration, which so ably exposed the imperial threats to colonial self-rule, also affirmed the self-evidence of Lockean natural rights. Hence, no consensus was ever reached over whether the liberal or the republican was the more influential discourse or how the simultaneous appearance of both political idioms could be logically reconciled.

While the keepers of the liberal faith and the purveyors of republican revision both viewed the founding in a secular light (as either looking forward to a progressive and capitalist future or backward to an ancient and pagan past), other scholars were busy exposing the vital role religion played in the period. Bonomi, Fliegelman, Goen, Greven, Gaustad, and others appropriately placed a deep Protestant faith high on the altar of eighteenth-century American life, where it had historically stood. What, then, was the significance of a Godly worship for the social life and political thought of the times? And what problems might the playing of this religious card pose for the Lockean liberal and civic republican readings of the American founding era?

In *The Myth of American Individualism*, Barry Alan Shain has furnished some provocative answers. Reviewing a vast and impressive literature, Shain simultaneously debunks both the Lockean liberal and civic republican theses. With the revisionists, Shain bears witness to the communal character of the founding era. In contrast to the civic view, however, he finds that Americans willfully gave themselves not to a spirited public life, but to the spirit of the Lord that dwelled within the breast of each believer. The republican tradition "insisted that full human development was only achievable through direct political participation." But Protestant America "did not understand political life as having intrinsic worth or as defining the sole path toward full human development." As "a largely Christian and overwhelmingly rural people, Americans...understood politics as instrumental in the service of higher religious and other publicly defined goals." Their conception of liberty (which Shain denotes "English political liberty") "emphasized the instrumental rather than the intrinsic value of political life." This emphasis bespeaks their abiding confidence in the Protestant path of human development marked out by "faith," "allegiance to family," "dependence on God's love and his freely given grace," and most important, "brotherly [or] communal oversight" (pp. 272, 275–76). This last feature signified a commitment to "an intrusive form of politics," one that left little room for individual autonomy and self-assertion—hence the "myth" of American individualism. In 1776, Americans rallied not against intrusive political power per se, but merely against the unwelcome imposition of far-off state, continental, and imperial legal mandates. At home, Americans actively upheld "the ethical intrusiveness of communal life." Humankind is fitted for

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society, and it is fit that society guide and direct every member along his or her God-given path. Early American society could thus be characterized as "coercively communalistic," "majoritarian," even "totalitarian." Individuals might pull up stakes and depart to foreign parts, but "what they could not choose was self-defined, individualistic freedom" (p. 59).

Up to a point, Shain's account is clear, coherent, and compelling. A good measure of plausibility must attend a theory that recovers and integrates relevant religious commitments into the broader social and political context of the age. Nonetheless, substantial problems undercut the book's usefulness. Methodologically, there is a persistent dropping of context, a failure to consider the full body of available evidence. This results in a sizable number of substantive flaws. Thus, in a book exceeding 300 pages, Shain fails to furnish any clear examples of American communalism at work. Missing are any telltale signs of the totalitarian intrusiveness he ascribes to those "Christian utopian, closed corporate communities" (p. 64). In fact, he devotes considerable effort to explaining precisely why America "initially failed to develop in a recognizably authoritarian way" (p. 110). He points to common-law traditions, more tolerant policies imposed by larger, governing political units, the absence of coercive (police) mechanisms, and the need to keep skilled hands from leaving town. Moreover, Shain entirely fails to confront the many scholars who have attested to the steadily expanding individualism of the age (e.g., Appleby, Bonomi, Fliegelman, Green, Hamowy, Kramnick, Pangle, Wood). He cites all these sources in his extensive bibliography and makes passing references to many of them in his text, but makes no effort to refute or reconcile their competing claims. There is also a selective reading of the primary sources. Shain takes the testimony of those who duly condemn those human impulses he identifies as selfish and individualistic. Yet he often overlooks the clear support for individualist constructs (e.g., religious toleration and an inviolate right to the just fruits of honest industry) expressed early on by these same authorities (James Wilson, John and Samuel Adams, Jefferson, Jonathan Mayhew, Abraham Williams, William Livingston, and Benjamin Rush, to name but a few).

In the end, we are left with much the same puzzle that resulted from the republican revisionists' amassed research. How are the individualistic and seemingly communalistic strains of early American life and thought to be reconciled? Part of the answer lies in a time-frame analysis. As Wood controversially projected an "end of classical politics" thesis, so Shain sees the *end of Protestant politics* in an emergent individualism, by the 1780s. But this individualism was manifested throughout the founding era. More fundamentally, then, one must gain a clearer understanding of the conception of "individualism" Shain finds "mythic" and absent in the Revolutionary period. It is a peculiarly modern conception, one that "awards an elevated

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standing to the express wishes and arbitrary or even irrational needs of the individual" (p. 117). This individualism "is founded on a mixture of secular faith in human goodness and irremediable epistemic uncertainty concerning the particular ends humans are to pursue" (p. 128). Perhaps we should scratch human goodness, for the individual Shain is looking for more resembles Hobbes's atavistic atom than the social being who finds ample space in the social theories of Locke or Jefferson. This individualism also reflects a modern liberal neutrality that can offer no necessary final ends for human conduct—one that, if it did, would defeat the principle of pluralism and pave the way to an authoritarian and therefore illiberal politics.

None of this obtains in the early American context, where an overwhelming concern for the public good and the laws of nature and of nature's God spelled out a specific moral course individuals were obliged to pursue. By freedom, then, Americans "did not mean negative liberty *from authority* so much as...positive liberty *toward* the goals of a dedicated Christian life.... The Revolutionary generation would have found the contemporary understanding of individual freedom to be a form not of liberty, but of license" (pp. 119–20). Shain here invokes much of the testimony the republican revisionists incorporated in repudiating the liberal or Lockean reading of the period. He and they thus rely on Americans' invocation of "the public good" and the incessant warnings raised against human selfishness. Over and over, Shain points to his patriots' tireless denunciations of the untrammeled pursuit of self-interest and the riotous sinfulness of the "self" itself. As one typical American put it, here was "really the root of all the vices in the world," because "a selfish person will promote his own private interest at the expence of the public" (Jacob Green, vice-president of Princeton University, quoted on p. 101). Early America demanded that "the passions of the self must be constrained within a social framework and that little freedom was needed beyond that required in the service of familial, societal, divine, or rational ends" (p. 103). These pious voices expressed a steady "hostility to self-centered activity [and] maintained a particular aversion to a driven pursuit of wealth." As Shain urges, "This was not yet a world, then, of individualism or of glorification of the autonomous individual. Rather, it was one in which most available theories of the good continued to teach self-overcoming, public shaping of the individual, and sacrifice for the public good" (p. 109).

All this is true. And yet it constitutes no reason to disavow Americans' simultaneous commitment to individualism, properly understood. Early American individualism was not modern in the (antiperfectionist) sense of being detached from any deeper philosophical outlook. It was a perfectionist formulation built on a clearly defined moral and metaphysical foundation. It did place strict bounds on individuals' conduct. But moral Americans hoped

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their countrymen would overcome only the rapacious and immoderate passions. Legitimate self-interest was not anything any self-serving John, Jane, or George might take an interest in, be it another man's property, another woman's husband, or an unbounded measure of power. It did not signify the factious freedom to corrupt public office for private profit or apathetically evade one's civic duty, thus endangering the welfare of all. Contradictions with respect to the treatment of African slaves and Native Americans aside, no individual was free to violate the freedom of others or the public good ("the good of all collected," as Paine explained). But in a land of unbounded opportunity, individuals were free to live where and worship as they wished, to pursue their chosen callings and enjoy the just fruits of their honest exertions, and to seek their happiness in peace and safety. In these many respects, all blemishes on the historical record aside, American individualism was anything but a myth.

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✦ Emancipating Slaves, Enslaving Free Men: A History of the American Civil War

By Jeffrey Rogers Hummel

Chicago and LaSalle: Open Court, 1996.
Pp. xiii, 421. $39.95 cloth, $19.95 paper.

In *Emancipating Slaves, Enslaving Free Men*, Jeffrey Rogers Hummel, a professor of history and economics at Golden Gate University, presents a short, readable, and reliable history of the Civil War. Several chapters are devoted to the political and economic background to the Civil War and two to its consequences. The study is based on extensive reading and a thoughtful approach to the analysis of certain key issues. Although much of the narrative is a well-presented version of current views, in a number of areas Hummel's arguments reflect a more individual approach. In addition to the text, fifteen excellent bibliographic essays, totaling more than one-quarter of the book, acquaint the reader with much of the relevant recent literature and, at times, present the author's disagreement (or agreement) with these works in more detail than in the text. Indeed, readers will probably learn more about the author's opinions from these bibliographic essays than from the text.

The major areas in which Hummel differs from current standard views generally reflect his strong antigovernment views, leading him to argue that the increased centralization of the North during the war, which many regard favorably, was rather costly to the pursuit of its interests. This reason is one

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of several—military decisions being another—for Hummel's general anti-Lincoln attitude. Hummel claims that the Civil War was "America's real turning point" in beginning "its halting but inexorable march toward the welfare-warfare State of today" (p. 359). The war also caused increased centralization in the South and, unlike the numerous historians who have argued that the southern defeat reflected too much decentralization, Hummel argues that "Vice-President Alexander Stephens had it exactly right. The despotic centralization of Jefferson Davis and his West Point cabal alienated the southern people from the cause of independence" (p. 289). The resulting loss of morale explained the southern defeat and the South's failure to continue with some form of guerrilla warfare. Though the argument of loss of morale has been made, it is usually attributed more to class divisions within the South than to overcentralization of the government. Either way, the villain would be Jefferson Davis, so perhaps there is less to the disagreement than appears. In general, however, although wartime centralization occurred in both North and South and the scope of government action expanded at federal, state, and local levels, the next fifty years differed substantially from the aftermath of World War I, leaving some lags and reversals to be accounted for.

To claim that the centralization that did occur during the war was somehow avoidable and not inevitable, it is necessary to argue that the war was unnecessary and need not have happened. Given Hummel's views on human rights and the present clear consensus on the evils of slavery, his position must then account for an ending of slavery without warfare. Historians confronted a similar problem in the 1920s, in their reaction against World War I and with the ensuing belief in the undesirability of war. Charles Ramsdell and others solved the problem by arguing that slavery had become economically doomed and soon would have been voluntarily ended by the South because of its unprofitability. One difficulty in this argument, however, was that no specific time was specified for this termination. In the 1850s, Lincoln, George Tucker, and others did provide a time horizon of about 100 years, which, if accurate, poses some moral problems. Given the research on the slave economy in the past four decades, Hummel believes that this economic argument is somewhat limited, but he claims that slavery was "doomed *politically*" because of its accelerated decline in the border states and the expected (by him) repeal of the Fugitive Slave Law, which would raise the costs of enforcement in the South and allow more slaves to escape to the North. Then, he argues, "the peculiar institution's final destruction within an independent cotton South was inevitable" (p. 353). Here, again, no time span is specified. In Brazil and Cuba, where slavery was "politically moribund," slavery did not end until the 1880s.

Hummel's argument that one can consistently hold views "passionately

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opposing slavery and simultaneously favoring secession" (p. 353) implies either the acceptance of the institution for an indefinite future or a belief that more and more pressure could be placed on the South without provoking warfare. Further, if, as Hummel argues, the right of secession is accepted and if slavery would have ended without war, the cause of "the Civil War was the refusal of Lincoln and other northerners to honor the revolutionary right of self-determination" (p. 351, quote from William Appleton Williams). Thus, Hummel's consistent antiwar, anti-government-centralization argument rests on the resolution of a key empirical issue: how much time would pass before emancipation would be voluntarily agreed upon.

The text of the book covers the first part of its title at length, but the second part, *Enslaving Free Men*, in less detail. Hummel quotes the abolitionist Ezra Heywood, who said in 1864 in response to the draft acts that "the right to draft men is as purely imaginary as the right to enslave them" (p. 254). In regard to conscription in the South, Hummel observes that it "had led the nation of black agricultural slavery to the ironic but appropriate adoption of white industrial slavery" (p. 251). In contrast to some of the recent literature, he views the economic fortunes of freedmen in the post-bellum South as having been more favorable. There was impoverishment, but also gains due to the ending of slavery and the increase in leisure and, over time, gains in measured black incomes. The villain, to Hummel, was not sharecropping but the "government-induced derangement" (p. 326) of the monetary system due to the imposition of the National Banking System, which, he argues, ended "probably the best monetary system the United States has ever had" (p. 224). Weaknesses of the antebellum system, alleged via "trumped-up charges of financial instability" (p. 224), sprang from too much, not too little, regulation. Perhaps, but why wasn't the Civil War monetary system terminated as soon as possible? An argument made by Charles and Mary Beard, that in the absence of the Civil War the basic changes in government economic policy would still have taken place because of the continuing changes in the structure of the economy, raises important questions about the war's relation to the expanded government role.

Hummel's discussion of the slave South treads more familiar ground in arguing for the profitability of slavery and the antebellum growth in measured southern output. He points to the lowered social profitability of slavery once the welfare of the slaves is included in the calculus, and argues that the gains from slavery accrued primarily to consumers of slave-grown products. There is an interesting discussion of enforcement and control costs, which are not evaluated financially, however, for their effects on slave prices or nonshareholder income; nor are similar costs examined for the urban North. Also of interest are the discussions of the effects of various forms of black

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resistance. There is a tension in Hummel's attempts at reconciling slave resistance and the slave's desire not to work with the high and rising prices paid for slaves over time. The behavior of slave prices raises questions about the political doom Hummel believes awaited slavery in the South.

It is not possible here to cover the many issues raised by Hummel and to make frequent comparisons with the arguments of other historians and economists on these questions. Hummel has written a useful short history of the Civil War that will be of interest to both scholars and the general reader. I highly recommend it as a most stimulating and educational read.

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✦ From the Outside In: World War II and the American State

By Bartholomew H. Sparrow

Princeton: Princeton University Press, 1996.
Pp. xv, 354. $45.00 cloth

The major theme of *From the Outside In* is that "states make war; wars make states" (p. 3). The book describes how World War II affected the growth of the federal government in four different areas: social security, public finance, labor-management relations, and naval procurement. The external ("outside") threat forced the federal government to develop its resources. Thus, the American leviathan was built "from the outside in." The author concludes, however, that the growth was uneven and in some cases might have been greater had the war not intervened. In general, Sparrow's work lends support to Robert Higgs's "crisis" theory of government growth, but it raises additional questions about the nature of wartime politics.

Why does government grow? Scholars have attributed the growth to rising affluence, the pressure of interest groups, the empire-building of bureaucrats, and the extension of the vote to previously disenfranchised classes. Robert Higgs, in *Crisis and Leviathan: Critical Episodes in the Growth of American Government* (New York: Oxford University Press, 1987), made a convincing case for the importance of crisis in explaining the timing of government growth in the United States. During a depression or war, the public demands government action. Programs created to deal with the emergency survive after the crisis has passed. In the postcrisis phase, government is reduced but remains larger and more powerful than it would have been in the absence of the emergency (the "ratchet effect").

Sparrow accepts the crisis theory of government growth but adds a

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"resource dependence" perspective drawn from the organizational theory of Jeffrey Pfeffer and Gerald Salancik (*The External Control of Organizations: A Resource Dependence Perspective.* New York: Harper & Row, 1978). Although we can expect government to grow during a crisis, the growth will vary depending on the resources that government can extract from the private sector. Resource dependence theory emphasizes the external constraints on government: the state must secure its resources (tax revenues, goods, and services) from the private sector through either cooperation or coercion. Democratic governments are further constrained by their need to please voters. During World War II, American voters wanted "the war conducted as quickly and painlessly as possible, without labor unrest, without untoward inflation, and with the fewest possible casualties" (p. 20). Consequently, the government could not rely solely upon coercion; it had to seek the cooperation of those who controlled the resources needed to conduct the war. Resource dependence theory is the social scientist's way of stating that the government must deal with the "outside" world, even during a crisis.

From the resource dependence model, Sparrow derives several sets of hypotheses about how government is expected to grow during a crisis. Many of these hypotheses express the obvious: for instance, the president will direct "state-building" where he has the constitutional power to do so (e.g., military procurement, debt financing), while Congress will maintain control of state-building in its constitutionally appointed areas (e.g., taxation). The frequent references throughout the text to "Hypothesis 1a" or "Hypothesis 3c" are confusing and distract from Sparrow's main point, which is that the war had "uneven effects" on government growth (p. 258).

Social Security exemplifies government growth forestalled by a wartime crisis. World War II marked the "missing years" of Social Security; the most significant expansions of the system occurred before and after the war. In the late 1930s, an increase in Social Security benefits received growing bipartisan support. During the war, however, Congress refused to raise benefit levels (except for veterans), though it did dramatically increase the number of beneficiaries and "contributors" (i.e., taxpayers).

The war years witnessed the maturation of the labor movement. Labor leaders cooperated with the Roosevelt administration by pledging not to strike. Cooperation yielded an increase in union membership and a general decrease in labor militancy. In the late 1940s President Truman lost his wartime authority over labor-management relations. Nevertheless, by 1950 a clear "ratchet effect" had occurred: the federal government was much more actively involved in mediating disputes than it had been before the war.

World War II also brought about a revolution in government finances. The revenue demands of the war led to a dramatic increase in income tax rates, the introduction of withholding, and the mass marketing of govern-

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ment securities. The monumental success of this revenue raising marked the triumph of "commercial Keynesianism." Policymakers now believed they could manipulate the economy to ensure full employment. The newly created financial mechanisms remained after the war, and the government used them to finance its growing domestic and international commitments.

In a case study of naval procurement, Sparrow challenges the conventional wisdom that large corporations reaped huge profits from their military contracts. Although many procurement officers were corporate executives who subsequently returned to private industry, Sparrow rejects the view that they made up a "power elite" beholden to big business. Marxist historiography notwithstanding, the federal government was not a "class-based American state" serving the interests of greedy capitalists (p. 248); "money did not rule, and corruption did not run rampant" (p. 285). On the contrary, the military kept corporate profits low. (The poor performance of the stock market undoubtedly reflected this poor profit picture.) The congressional gnashing of teeth over "excessive war profits" was much ado about nothing. Similarly, congressional concern that the small manufacturer was being squeezed to death was unfounded. Small manufacturers actually achieved much greater profit increases than their larger counterparts (a point I make in my own study of business during the war, *Beyond the Broker State: Federal Policies Toward Small Business, 1936–1961.* Chapel Hill: University of North Carolina Press, 1996).

Sparrow also questions the notion that the war created a "military-industrial complex." He rejects Gabriel Kolko's argument in *The Roots of American Foreign Policy: An Analysis of Power and Purpose* (Boston: Beacon Press, 1969) that the military-industrial establishment constituted a "ruling class" able to defend its interests before Congress. According to Sparrow's account, the military-industrial complex "collapsed" as a result of the rapid demobilization at the end of the war (p. 163). There is some truth to Sparrow's argument. Radical critics of the "military-industrial complex" overstate the political influence of defense contractors. Indeed, defense spending is the one area of government that has endured deep cuts in recent years. The marginal benefits of defense spending are not readily apparent to voters; consequently, the military presents an easy target during budget-cutting sessions. (Witness the current treatment of the military by a "conservative" Congress.) Nevertheless, the fact remains that a bureaucratic structure resembling a "military-industrial complex" remained in place. The war strengthened the ties between industry and the military. Military spending was higher than before the war, and the government was committed to research and development of new weaponry. The low profits of military contractors signified only that the government had the upper hand in its relations with defense contractors. This shouldn't be surprising: business

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executives have long regarded the federal government as "the worst customer in the world." Despite these criticisms, Sparrow has a point: The military-industrial complex did not achieve a much higher share of federal spending until the outbreak of the Korean War.

Sparrow offers several valid and useful modifications of Higgs's crisis theory. Higgs emphasizes the government's attempts at cost concealment (e.g., disguising inflation through wage-price controls). Sparrow notes that the government was not very successful at concealing the costs of the war. (Of course, one can wonder how any government could hide that it was suddenly consuming half the output of the economy.) The high tax rates were obvious, and the extension of the income tax to middle-class Americans meant that Everyman felt the pain of taxation for the first time. No wonder so many people complained about high taxes and obnoxious government controls on consumer goods. The one hopeful lesson of the war is that taxpayers have their limits. By broadening the tax base, the federal government created a pool of disaffected voters.

Sparrow stresses that the war involved more than an amplification of existing demands for governmental action—it also transformed the political agendas of various interest groups. Most important, the war absorbed several of the social movements of the 1930s. The militancy of the "old-age" activists and labor leaders gave way to negotiation within the confines of the post-New Deal broker state.

From the Outside In is an important addition to the literature on government growth, but its social science jargon and narrative detail will challenge all but the most persistent reader. Nevertheless, it points in the right direction: We need more administrative histories of agencies responding to crisis. Only then will we have a complete understanding of the causes and consequences of government growth in the twentieth century.

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✦ Oil, Gas, and Government: The U.S. Experience

By Robert L. Bradley Jr.

Lanham, Md., and Washington, D.C.: Rowman and Littlefield Publishers and the Cato Institute, 1995. Pp. 2000. $195.00 cloth (2 vols., available separately $125.00 each).

About fifteen years ago, when memory of the energy crises of the 1970s remained fresh in everyone's mind and the inevitability of future energy crises was the unchallenged premise of public policy, I decided to write a book

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about the causes of and cures for chronic energy crises (*Politics, Prices, and Petroleum: The Political Economy of Energy*. San Francisco: Pacific Institute for Public Policy Research, 1985). My diagnosis was straightforward: The energy crises sprang from the controls on energy prices that were the sole legacy of the comprehensive wage and price controls that Richard Nixon, in a display of towering cynicism, inflicted on the American economy in August 1971. Outflanking his Democratic opposition, he embraced the very "anti-inflation" policy of stopping inflation by outlawing price increases that the Democrats had proposed in the credulous belief that Nixon would never forsake his free-market principles, let alone renege on his solemn pledge never to impose wage and price controls.

Nixon got all he really wanted from his betrayal—a landslide electoral victory over a fractured opposition and a hapless opponent. The costs of that fateful decision were left for others to bear when the legal suppression of the price mechanism prevented a smooth adjustment to the very small supply disruptions associated with the so-called Arab oil embargo of 1973 to 1974 and, about five years later, with the fall of the Shah of Iran. The adjustments would have occurred automatically in a free market but, in its absence, horrific shortages of gasoline that traumatized the entire country inevitably resulted. As Nixon himself later admitted in his memoirs, his U-turn was prompted entirely by political, not economic, motives. If a group of oil executives had ever hatched a conspiracy for their own benefit with the total disregard for the public interest displayed by Nixon and his co-conspirators, among whom it is depressing to recall were such eminent economists as Arthur Burns and Herbert Stein, they would have been lucky to escape with their heads. Although Nixon did leave office in richly deserved disgrace, neither he nor his collaborators were ever called to account for their crime of 1971.

Despite the actions of the Nixon administration and its immediate successors, the republic somehow survived the misbegotten system of price controls on oil and refined products until 1981, when Ronald Reagan finally terminated them amid a chorus of critics predicting that the sky would fall. Except when oil prices were rising so rapidly that regulatory ceilings could not keep pace with them, those ceilings were not binding at the margin. Except during such periods, it was always possible and profitable, at the margin, to obtain crude oil or refined products from uncontrolled sources, mainly imports. And except for the relatively brief periods when controls were wreaking havoc on the country, the chief effect of controls was not to hold down prices to consumers but to transfer wealth from the unlucky suppliers who could not circumvent the controls to intermediate purchasers who could finagle the system in order to resell products at or near the market-clearing price.

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The susceptibility of the system to such abuses was fortunate because without the abuses the controls would have wrought even greater havoc. Which is not to say that the controls were costless when they were not binding. Far from it. By creating a huge regulatory windfall that practically everyone in the oil industry was competing mightily to get a piece of, they caused enormous distortions and waste. But compared to the chaos that resulted when price ceilings were binding at the margin, the waste caused by nonbinding controls was clearly of a second order of magnitude.

With the passage of time, the size of the wealth transfer effected by price controls eroded, and the gradual and very imperfect recognition that the controls were having undesirable effects helped to bring about their eventual termination. It would be gratifying, but not very realistic, to think that my book and others like it were responsible for this recognition. Nevertheless, when one recalls how in the 1970s and 1980s we were scolded incessantly for our wasteful use of energy when it was obvious to the enlightened that we were rapidly running out of oil, how we were subjected to the shrill demands of the best and the brightest for a comprehensive national energy policy to prevent a renewed energy crisis of which the shortages of 1973 to 1974 and 1979 were mere previews, and how we were told that the need for such a policy reflected the broader need for economic planning on a national, even international, scale, one becomes, perhaps, a shade less pessimistic about the possibility of bringing reason to bear on public policy-making.

By writing a truly encyclopedic work on the history of government policy toward crude oil, refined products, and natural gas, Robert D. Bradley has performed a public service of dimensions commensurate with the imposing size of his two-volume, 2,000-page book.

The history of government intervention in the markets for crude oil, refined products, and natural gas is much longer than the decade of price controls from 1971 to 1981. Although the controls of that period were the most egregious example of misguided government intervention, Bradley makes it clear that the policies of that period were hardly aberrations. In fact they served many of the same interests that had benefited from earlier government intervention in petroleum markets.

Although the outstanding quality of Bradley's work is the author's unparalleled knowledge and mastery of the institutional history of the oil and gas industry and of government intervention in the industry at both the federal and state levels—a knowledge he shares with admirable clarity and insight—it is ironic that the main criticism one can direct against him relates to his ideological a priori attachment to the belief that any form of government intervention in the market economy must always and everywhere be pernicious and counterproductive.

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This view was first expounded systematically by the eminent Austrian economist Ludwig von Mises. Though it contains the powerful insight that interventions usually have unintended (and undesired) consequences that may lead to further interventions and further unintended consequences, and though many (including me) believe that it comes much closer to being right than wrong, not many would accept it in the categorical form in which Mises expounded it. Even one of Mises's most devoted students and followers—and surely the greatest of them—F. A. Hayek, did not accept it categorically. It has, however, become a staple of the neo-Austrian school that Mises transplanted to American soil after World War II, of which Bradley is a dedicated adherent.

Despite its a priori character, advocates of this view often support it by offering empirical examples of interventions and regulations that produce effects unanticipated by their supporters. Bradley has an almost inexhaustible supply of such examples. But all examples can do is raise doubts about the balance of costs and benefits in each individual case; they can't support the universal claim that Bradley and other neo-Austrians insist on. No universal a priori proposition about the costs and benefits of intervention can be inductively inferred from individual cases, however numerous, in which government intervention has been shown to be counterproductive.

Arguments in favor of intervention can be countered in two ways, either by showing that the balance of benefits and costs weighs against a particular intervention or by advancing a moral or political argument against such interventions that is independent of the balance of benefits and costs in any particular instance. At best, Mises's argument helps us understand why the balance of costs and benefits so frequently tilts against the interventions. On the other hand, moral and political arguments, to be persuasive, must entertain at least the possibility that in specific cases the interventions might be welfare improving.

Bradley gets into deep trouble particularly when arguing that antitrust laws are bad in principle and an illegitimate infringement on the market economy. It would be one thing to argue that in the past antitrust laws have done more harm than good, or even that in the future antitrust enforcement is likely to be harmful. But Bradley argues that it is wrong in principle for government to proscribe collusion between competitors. Why? Because collusion may help companies achieve certain efficiencies, such as better planning for future output, that could not be achieved otherwise. If such collusion were to harm consumers, the colluders would then have an incentive to cheat on their agreements, and newcomers would have an incentive to enter markets in which collusion was raising prices. Thus, the outcome that results by allowing collusion to take place is necessarily the most desirable.

Although Bradley asks us to consider the savings that might be made if

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firms were allowed to collude, he gives no consideration at all to the losses that would result if firms were allowed to make binding contracts with their competitors about what their future prices or output would be. We have little empirical basis for projecting how our economy would perform if such contracts were legal. Like most economists, I suspect it would not perform as well as it would if they were not legal. Bradley believes otherwise, but does not acknowledge that this question does not admit of an a priori answer.

This quest for philosophical closure and abstract certainty is not only quixotic but probably self-defeating, because it can be sustained only by retreating into a defensive anti-empirical posture that refuses to expose theoretical propositions to the risk of factual refutation. This sort of metaphysical approach to economic analysis is unlikely ever to be found either relevant or persuasive by more than a relative handful of true believers. Fortunately, in his monumental study of the regulation of the oil industry, Robert Bradley has not allowed the implicit anti-empirical bias of his ideological position to deter him from the tireless collection and presentation of factual evidence. His historical insights provide impressive and persuasive support to most, if not all, of his ideological and policy conclusions.

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✦ Plowing Ground in Washington: The Political Economy of U.S. Agriculture

By B. Delworth Gardner

San Francisco: Pacific Institute of Public Policy, 1995.
Pp. xiii, 385. $29.95 cloth.

In *Plowing Ground*, Del Gardner presents an extensive, well-reasoned critique of U.S. agriculture programs that is accessible to a wide range of potential readers. He writes primarily for educated laypersons, seeking to give them a better understanding of agricultural policy—how programs work, the effects of different programs and policy tools, and the functioning of the political process through which policy is enacted. He argues that

> farm policy as it exists today (1) distorts the economy and produces significant efficiency loss that reduces average standards of living, (2) massively redistributes income and wealth from taxpayers and consumers to farmers, primarily landowners, who are now richer than average Americans, and (3) degrades and despoils the natural and physical environment in significant ways. (p. xi)

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Gardner devotes a considerable portion of the book to explaining why such negative-sum policies are enacted and why they have persisted so long.

Part 1 of *Plowing Ground* is composed of five chapters. The first discusses the political climate surrounding the 1985 farm bill and provides a brief history of U.S. agricultural programs. Gardner indicates that although he and other students of agricultural policy expected implementation of major changes in the 1985 farm bill, the Food Security Act of 1985 for the most part simply extended earlier agricultural programs. He uses the inconsistencies between expectations and realizations in 1985 to motivate his inquiry into the causes and effects of agricultural policies. In chapters 2 and 3 the concepts of efficiency and equity are introduced, the role played by prices in a market economy is discussed, and some impacts of selected agricultural policies are examined. Issues receiving particular attention include the efficiency effects of trade barriers, the validity of arguments that price supports and marketing orders increase stability, and the impacts of agricultural policies on input usage. Chapter 4 provides a case study of the credit policies of the Farmers Home Administration (FmHA). Gardner demonstrates the extremes to which these policies go to keep farmers from failing, and he makes a convincing case for their overall inefficiency. Chapter 5 pertains to the distribution of agricultural support payments. Here Gardner presents data demonstrating that the bulk of these payments goes to large, wealthy farmers rather than small, low-income family farmers.

In the four chapters of part 2, the author answers the question "Why (given the failures of farm policy discussed in part 1) do farm programs exist and persist?" Among the several possible answers to this question considered in chapter 6, Gardner gives most credence to the "public choice" explanation. In the context of agricultural policy, public choice principles suggest that small producer interest groups with large individual stakes in political outcomes will lobby successfully for the enactment of legislation that imposes small per-person costs on large numbers of taxpayers and consumers. Thus, the existence and continuation of programs such as the sugar program, from which a small number of sugarcane processors and growers and high-fructose-corn-sweetener producers gain millions of dollars annually, while individual consumers bear costs of about five dollars per year (United States General Accounting Office, "Sugar Program: Changing Domestic and International Conditions Require Program Changes," GAO/RCED-93-84, April 1993). In chapter 7, Gardner presents an economic model of the supply and demand for favors in political markets. From the model, he derives hypotheses concerning the ability of different agricultural groups to obtain subsidies. He uses the model to explain the credit subsidy policies of the FmHA. In chapter 8 the author discusses relevant aspects of the structure of Congress, in particular the role of

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committees and subcommittees, and the growing importance of political action committees (PACs). In chapter 9 he displays data showing the contributions of the agricultural PACs that contributed the most in the 1988 election cycle. He then presents and discusses the results of a statistical analysis designed to test the hypothesis that "PAC contributions are directed to those legislators who are most likely to produce political favors of benefit to the PAC constituents" (p. 207). The conclusion: PACs make their contributions "where they have the highest payoffs for the interest group represented" (p. 234).

The three chapters of part 3 focus primarily on the environmental impacts of agricultural policies. Chapter 10 examines the various impacts on soils and wetlands. Important arguments include (1) but for price supports, much highly erodible land in crop production would not be so used, (2) the Conservation Reserve Program has been successful in transferring wealth to farmers but not in achieving its stated environmental objectives, and (3) farmers have strong incentives to take economical measures to reduce soil erosion without government intervention. In chapter 11, Gardner discusses the relationship between agricultural policies and chemical contamination of the environment. He argues correctly that the issues involved are complex and that "effective programs have yet to be conceived and implemented" (p. 286). Federal reclamation projects, the irrigation subsidies associated with such projects, and their economic and environmental consequences are the topic of chapter 12. Gardner demonstrates that irrigation subsidies are substantial and argues that federal water policies, in general, have had negative effects on the natural environment in the West.

Part 4 of *Plowing Ground* consists of a single chapter, in which Gardner discusses the prospects for reform of agricultural policies and the political process. On the former, he generally advocates the elimination of government programs that interfere with market functions. Realizing that political realities preclude total elimination of agricultural programs, he suggests several changes that he believes would result in net improvements. One notable suggestion is to decouple income support payments from production decisions, which would reduce the distortionary impacts of current subsidy payments. From the perspective of farmers, the political disadvantage of decoupling is that the size and nature of government subsidy payments would be more obvious to taxpayers.

For the most part, this book should be highly readable by educated nonacademic laypersons. By not including a single supply/demand graph to illustrate the impacts of agricultural programs, Gardner keeps his targeted audience from getting bogged down in the technical aspects of the economic analysis of such programs. Perhaps, however, the reader *will* get bogged down in the institutional details of some of the issues and policies

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that Gardner discusses in detail. For example, his detailed discussions of the rules regulating PACs and of the details of the Conservation Reserve Program and target-price programs may challenge the attention span of some readers. On the other hand, his focused discussion of particular policies is useful because it provides the reader with some inkling of the extreme complexity of agricultural programs—a point that any book on the topic would be remiss in not making.

One portion of the book, however, does seem somewhat out of place in a book targeted for noneconomists. This is the extensive multiple-regression analysis in chapter 9 of the determinants of PAC contributions. Although the author explains the meaning of these findings well and does warn readers in the preface that noneconomists may want to skip this material, this section strikes a discordant note.

For economists unfamiliar with agricultural programs, *Plowing Ground* could well serve as a useful primer on agricultural policy and its problems. It might also function as a helpful text for a university course on agricultural policy, although analytical rigor would have to be provided by the professor or other texts on the topic. Economists familiar with U.S. agricultural policy may find some interesting insights and material in this book—for example, Gardner's discussion of the current Conservation Reserve Program is one of the few that I have encountered whose overall tone is critical. Also, the three chapters in part 3 on agricultural policy and the environment provide good single-source references on these issues.

A problem with the book—albeit one clearly beyond the author's control—is that on some issues it is already out of date. The inevitable lag between writing the book, seeing it through the publishing process, and the writing and publishing of reviews like the present one means that several years have passed since Gardner set down his thoughts on then-current issues. The Uruguay Round GATT, for example, had not been signed at the time he finished the book. The Federal Agriculture Improvement and Reform Act of 1996 (the FAIR Act) was passed last year. This act made some important changes in agricultural policy, most notably the elimination of target-price programs. No longer receiving deficiency payments, farmers who participated in target-price programs in the recent past now have very few restrictions on what they can produce; they receive subsidy payments not tied to their current production of particular crops. This aspect of the FAIR Act accords with Gardner's call for decoupling. Other aspects of policy, however, remain unchanged: the structure of the sugar and peanut programs remains intact, export enhancement subsidies continue, loan rates and marketing loans remain in effect, and so forth.

Overall, Gardner has written a very good book on agricultural policy,

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one that will provide valuable information to readers unfamiliar with the topic and will be a useful reference for readers familiar with the topic.

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✦ The Failure of Antitrust and Regulation to Establish Competition in Long-Distance Telephone Services

By Paul W. MacAvoy

Cambridge, Mass., and Washington, D.C.: MIT Press and AEI Press, 1996. Pp. xviii, 314. $50.00 cloth.

AT&T's absolute monopoly of the supply of switched long-distance telephone services ended in 1976 with the rollout of MCI's outlaw Execunet offering. Twenty years later, economists are questioning whether AT&T remains able to influence the prices at which long-distance services are sold and, if so, to what extent AT&T exercises this market power. The first scholarly studies in this area relied largely on theory and deduction, and their results were ambiguous. Empirical studies followed, but the issue has remained unresolved.

Paul MacAvoy, a distinguished economist at the Yale School of Management and coeditor of the voluminous AEI Studies in Telecommunications Deregulation series, weighs in with a comprehensive quantitative study purporting to show not only that AT&T retains considerable market power but also that the long-distance industry performs as a tacitly collusive, three-firm oligopoly with AT&T leading itself, MCI, and Sprint to supercompetitive profits. MacAvoy's analysis shows that industry concentration and market shares stabilized around 1990 and that pricing and profit margins have converged and risen in lock step. The gravamen of MacAvoy's thesis is that long-distance markets never have performed competitively and, due to the persistence of regulatory and antitrust constraints, have moved systematically away from competitive performance.

MacAvoy's conclusions call into question the efficacy and direction of national telecommunications policy. If twenty years of regulatory and antitrust policy have failed to produce robust competition, then that policy has been a dismal and costly failure. His conclusions warrant attention, especially because policymakers have launched an even more adventuresome and potentially costly plan to transform the local telephone service monopoly into a competitive industry.

The book's title understates the thrust of its argument: it is not that the government tried and failed to create a competitive market but, rather, that

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the government didn't try at all. MacAvoy documents how federal regulatory and antitrust policies have been used to hamstring AT&T and to nurture its rivals, all to the detriment of competition. He suggests two possible explanations for these policies: regulators enjoy micromanaging the industry and have been reluctant to stop; and, more ominously, regulators may believe that unfettered competition is unsustainable.

MacAvoy argues that the country has been misled into believing that the long-distance industry is competitive. Factors contributing to this misapprehension include a large but inconsequential competitive fringe, ubiquitous advertising without substantial price competition, periodic price reductions that are attributable to regulatory fiat rather than to competitive pressure, frequent price structure changes without price level reductions, and telephone subscribers shifting custom among rival long-distance carriers in pursuit of elusive savings. Moreover, MacAvoy argues that the country has been misled by naïve, uninformed, self-congratulatory, and perhaps intentionally confusing proclamations by regulators, legislators, trustbusters, and sundry industry experts.

The regulatory history that MacAvoy meticulously documents covers well-traveled ground. The Federal Communications Commission nurtured AT&T's competitors while constraining AT&T's ability and incentive to compete aggressively on the basis of price. Price floors have shielded AT&T's rivals and preserved cherished pricing inefficiencies and cross-subsidies. AT&T files tariffs that other carriers quickly match to within a tenth of a cent, a regulatory game that facilitates tacit collusion by enabling firms to signal cooperation and to monitor conduct.

MacAvoy also criticizes the antitrust settlement that divested AT&T of its local telephone companies in 1984 and ostensibly placed AT&T on a level playing field with other long-distance carriers. He shows how federal antitrust (competition) policy went to war with national regulatory (cross-subsidization) policy during the 1970s and 1980s, when the Justice Department sought to unwind the monopolized industry structure that had arisen through state and federal regulatory action. He illuminates the confused state of these policies by highlighting incongruities in the government's economic theories of market power, leverage, bottlenecks, and predatory pricing. The AT&T antitrust settlement was presumed to harbinger a withering away of regulation, but MacAvoy shows that no withering occurred. Status-quo regulation continued, with the antitrust court adding its own notions of economic and social efficiency to the policy mix. The most damaging antitrust policy of all, in MacAvoy's view, was the court's decision to ban the divested Bell telephone companies from entering interLATA long-distance markets, a move that further limited the potential for robust competition. (*Editor's note:* LATA refers to local access and transport area. The

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United States in divided into some 160 such areas.) The Telecommunications Act of 1996 provides belatedly for market entry by the Bell companies, but MacAvoy argues that its provisions are so riddled with strategic opportunities for protracted litigation that new competition is unlikely to emerge in a timely fashion.

The upshot of these policies is that AT&T, MCI, and Sprint presently supply 90 percent of all intraLATA long-distance service, with the remainder being supplied by a competitive fringe of about 500 firms. Carriers seemingly rest content with supercompetitive profit margins and rock-stable market shares, a comfortable alternative to the price wars that followed deregulation in the airline and trucking industries.

The centerpiece of MacAvoy's work is an empirical analysis of industry concentration and profit margins across long-distance services and regulatory jurisdictions. Experience in other industries suggests that concentration in the long-distance industry should have fallen toward atomistic levels over time as new entrants gained business and as market shares gravitated toward equality. Economic theory predicts, in turn, that profit margins will fall in parallel with the decline in industry concentration. In graph after graph, however, MacAvoy shows that long-distance service sectors remain concentrated, with market shares in each sector holding stable at roughly 60 percent (AT&T), 20 percent (MCI), 10 percent (Sprint), and 10 percent (all others). MacAvoy shows that profit margins increased as industry concentration initially decreased—a divergence contrary to theoretical expectations—and continued increasing as concentration stabilized. He shows that profit margins have converged near 70 percent (i.e., estimated marginal cost equals thirty cents of the average revenue dollar), and compares these values to margins of 35 percent in other highly concentrated industries. And he reveals the unexpected absence of price shading among high-volume customers who ordinarily would whipsaw competing carriers into making price concessions. He supplements this graphical analysis with structural econometric models that put a fine point on his study of price leadership and tacit collusion.

Critics of MacAvoy's analysis may be tempted to regard his empirical results as self-condemning: it is difficult to accept that U.S. long-distance service is, by far and away, the nation's least competitive industry. Although MacAvoy's results may trigger initial skepticism regarding methodology, data, and assumptions, his sensitivity analyses show the results to be robust.

The uniqueness of the long-distance business may help to explain some of MacAvoy's most challenging results. Industry demand is known to be fairly price inelastic because there are no close substitutes for long-distance services at prevailing prices (industry elasticity values as low as –0.5 are

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commonly estimated). Consequently, the long-distance industry could profit more handsomely than most industries by tacitly colluding to raise prices, and so the finding that network profit margins exceed margins in other concentrated industries is not implausible. However, as MacAvoy observes in passing, network marginal costs have fallen vanishingly close to zero in recent years as total costs have become increasingly fixed with respect to usage. This fact not only may help to explain the rising profit margins that MacAvoy observes but also may limit the usefulness of margin comparisons with other industries.

To regard MacAvoy's work as definitive would be premature at this juncture. At least one contemporary empirical study supports precisely opposite conclusions regarding AT&T's market power (Simran Kahai, David Kaserman, and John Mayo, "Is the 'Dominant Firm' Dominant? An Empirical Analysis of AT&T's Market Power," *Journal of Law and Economics* 39 [October 1996]: 499–517). That contradictory study finds long-distance markets to be intensely competitive and shows AT&T to lack market power. The findings imply relatively low profit margins and so contrast starkly with MacAvoy's results. That these two credible studies reach opposite conclusions—other scholarly studies appear to be split about evenly on the issue as well—suggests unresolved problems of methodology, data, assumptions, and interpretation.

MacAvoy's work surely will serve to pique interest and heighten controversy, and deservedly so. Economists will sharpen their pencils, and policymakers will continue to regard all empirical work in this area with selective caution.

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✦ The End of Welfare: Fighting Poverty in the Civil Society

By Michael Tanner

Washington: The Cato Institute, 1996. Pp. vii, 226. $10.95 paper.

Michael Tanner, the director of health and welfare studies at the Cato Institute, has aptly titled his new book *The End of Welfare*. He is not alluding to President Clinton's pledge to "end welfare as we know it" but to his own preferred solution to the welfare mess: end all government welfare programs and rely on private charities. As recently as ten or fifteen years ago, few if any serious scholars would have had the audacity to offer such a radical proposal in print. It is a testament to the influence of Charles Murray's work and

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growing evidence of the defects of existing welfare programs that this proposal for seemingly draconian reform no longer seems unthinkable.

Tanner develops his argument in seven information-packed chapters as well as a brief concluding chapter. These chapters cover a lot of territory and are buttressed with an impressive 570 footnotes in only 183 pages of text (plus another 79 for the appendix, which gives brief descriptions of 71 [!] different welfare programs that compose the bulk of our welfare "system"). Although the book falls short of informing the reader of "everything you always wanted to know about welfare," the footnotes provide references to a large body of related literature.

The first three chapters provide background information concerning the current welfare system. Chapter 1, "Poverty in America," covers the definition and measurement of poverty, demographic characteristics of the poverty population, trends over time, the causes of poverty, and general economic inequality. With regard to the causes of poverty, Tanner emphasizes inadequate schooling, having children outside marriage, and not working: "It has been said that the surest ways to stay out of poverty are to (1) finish school; (2) not get pregnant outside marriage; and (3) get a job, any job, and stick with it" (p. 17). The emphasis on these factors, especially illegitimacy, is well placed, but I would like to have seen it acknowledged that even if everyone plays by these "rules," some people will still be poor. One doesn't have to accept everything in *The Bell Curve* to know that chance, whether of nature or nurture, gives some people insufficient abilities to earn an adequate income. In fact, it is precisely because of the suspicion that many people are poor "through no fault of their own" that we feel compassionate toward the poor.

In chapter 2, "The Rise of the Welfare State," Tanner discusses the early history of welfare in America, including the role of private charities, and the rise of the modern welfare state from the New Deal through the Great Society and up to the present. By 1993, total government spending on welfare programs had reached $324 billion. Tanner uses the familiar tactic of dividing this spending by the number of poor people: "For a poor family of four, that amounts to more than $33,000. If we simply gave poor people the money, we could raise every poor family above the poverty level for less than half of what we are now spending" (p. 58). The intended inference is either that a lot of the money goes inappropriately to people who are not poor or that the bureaucracy siphons off most of the funds. Neither is correct. Most of the resources do go to the intended beneficiaries, but are not counted; about 80 percent of welfare spending takes the form of in-kind transfers, and poverty is defined in terms of cash incomes only. Administrative costs of most government welfare programs are under 12 percent. Finally, of course, some nonpoor people do get substantial welfare benefits, enough to raise

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them above the poverty line. If we took away all these benefits, as suggested in the preceding quote, and gave them to people who are still poor, we would not eliminate poverty but cause millions who are now nonpoor because of welfare to become poor. For all these reasons, I wish commentators would stop using this fundamentally misleading argument.

In chapter 3, "The Failure of the Welfare State," Tanner charges the welfare system with increasing illegitimacy and family breakup, undermining work incentives, increasing crime (mainly through its effect on increasing the number of children in single-parent families, who disproportionately commit crimes), and fostering intergenerational dependence. There is ample evidence now, much of it cited by Tanner, that our welfare programs do have these effects. But that does not constitute proof that the system has failed unless one believes, as no one does, that welfare programs without any undesirable side effects can be designed. Much depends on how large the harmful effects are. Even Charles Murray believes that only about half of the increase in illegitimacy is due to welfare; many believe the effect is smaller. And surely some beneficial effects from providing $324 billion in transfers to low-income families should be balanced against these harmful outcomes. Even so, Tanner is surely correct to stress the undesirable consequences of our system that lead many observers to regard it as a failure.

Chapters 4 and 5 are titled, respectively, "Why Liberal Welfare Reform Won't Work" and "Why Conservative Welfare Reform Won't Work." In these chapters Tanner examines some of the favored reform proposals popular on the Left and on the Right. The favored liberal policies discussed are job training, child care, child support enforcement, and the Earned Income Tax Credit. The favored conservative policies discussed are workfare, subsidized jobs, LEARNfare, block grants, cutting "fraud, waste, and abuse," and restricting immigration. Given the limited space devoted to each of these issues, Tanner persuasively argues, with much evidence cited, that the proposed policies either won't work or at best will have modest benefits. Though one could quibble over details, I think Tanner is correct in suggesting that neither the mainstream Left nor the mainstream Right has come up with any proposals that would *significantly* improve our welfare system.

Tanner develops his solution in chapter 6, calling for an end to all government welfare programs and reliance on private charity. He counters the major objection—that charitable giving will be insufficient to deal with the problem—with two points. First, substantially fewer poor will need assistance in the absence of disincentives created by government programs. I don't find his arguments or evidence very persuasive on this point. Second, charitable giving will rise when government welfare is abolished. This claim is certainly true, and Tanner cites some of the empirical literature for support. But he

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does not point out that the evidence (my reading of it, in any event) suggests that each dollar cutback in government welfare will produce only five cents more of charitable giving. Because of the free-rider problem associated with individual voluntary giving, we can expect a massive reduction in the quantity of resources available to help the poor if we eliminate government welfare. Tanner does mention the possibility of using tax credits to encourage charitable contributions.

Although a number of private charities have been effective in helping the poor, reliance on private charity has disadvantages Tanner does not mention. For example, fund-raising costs typically run about 20 percent of total giving for major charities, so only 80 cents of every dollar given would be available to help the poor. And some of that 80 cents would have to cover administrative costs of the programs. Moreover, it is far from clear that private welfare won't have disincentive effects of the same sort that plague government welfare. (*Editor's note:* For historical evidence on this point, see Stephen T. Ziliak, "The End of Welfare and the Contradiction of Compassion," *The Independent Review* 1 [Spring 1996]: 55–73.) One notable omission in Tanner's book is an explanation of the intrinsic difficulty (bordering on impossibility) of designing any welfare program that will avoid substantial disincentive effects of the type he deplores.

In chapter 7, "Creating Opportunity," Tanner completes his argument by calling for major across-the-board cutbacks in government nonwelfare programs. Getting government "out of the way" is supposed to give rise to a more prosperous economy with greater economic growth, an environment in which the poor can better help themselves. Though many of the individual proposals discussed—privatize social security, eliminate the minimum wage, institute school vouchers—have merit, it does seem to be stretching to call for a general regime of limited government in the name of helping the poor.

All in all, I do not think that *The End of Welfare* will convince many readers that ending welfare is a panacea. Nonetheless, it ably presents a position that deserves, and one hopes will get, increased attention. No one is happy with the present welfare system and, as Tanner points out, it is unlikely that the recently enacted welfare reform will change matters much. A greater role for private charities, somehow achieved, probably will be an element in any true solution to our welfare woes.

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✦ Science on Trial: The Clash of Medical Evidence and the Law in the Breast Implant Case

By Marcia Angell, M.D.

New York: W.W. Norton, 1996. Pp. 256. $27.50 cloth.

In this concise, insightful, and inadvertently amusing book, Marcia Angell chronicles the background and history of the silicone breast implant debacle. In lucid language that both lay readers and scholars can appreciate, Angell shows that there is no scientific evidence that silicone breast implants are really dangerous, but the U.S. Food and Drug Administration (FDA) banned them anyway in 1992 in response to political and cultural pressures. The ban then triggered the largest tidal wave of tort litigation in history and instilled unwarranted fears and anxiety in approximately 2 million women who have implants. Angell provides a thoughtful analysis of the clash between the scientific evidence, the law, and public perceptions of the alleged dangers of silicone breast implants. She extends her discussion to the broader related issues of the need for tort reform in the United States and the increasingly popular antiscience sentiments that pervade the media and public thinking. She argues that without significant reforms and a return to science, society is likely to suffer serious health consequences that extend beyond the issue of breast implants.

The book is neatly organized into two introductory chapters, which provide an overview of the breast implant story, and six additional chapters dedicated to discussing the six broad themes Angell perceives as important in shaping society and the resultant implant ban in the United States. The themes are regulation, tort law, the ambiguous role of scientific evidence in society, science in the courtroom, the effect of profit motive on public life, and the way in which the media present medical issues to the public. The book is well written overall, although as a possible tool for scholars it suffers from an annoying tendency to use quotations without specific citations. Instead, Angell often cites an entire book as a reference for a specific quote.

First, discussing regulation, Angell reviews the role the FDA and its head, David Kessler, played in deciding to ban the implants. Angell asserts that Kessler came to the FDA with a combative style and a clear goal to strengthen the agency. A few highly publicized court cases in which plaintiffs allegedly injured by breast implants received large awards, as well as vocal input from Sidney Wolfe of Public Citizen (a Naderite consumer advocacy organization), led the FDA to respond "like a political body, not a regulatory body" (p. 25). Further, although the implants had been on the market

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for twenty years, implant manufacturers had not produced safety records on them. A battle of wills ensued between Kessler and the manufacturers.

Angell repeatedly emphasizes the absence of scientific evidence that silicone implants were dangerous at the time the ban was imposed. She notes the preponderance of anecdotes, sensationalistic case reports, and pseudoscientific testimony at biased FDA advisory panel hearings, where panelists included men who testified as plaintiffs' expert witnesses in implant cases.

Second, Angell discusses the role of tort law on American life in general and its impact on the rush to court with implant cases after the FDA ban. At the end of 1991, some 200 cases had been filed against Dow Corning, the major implant manufacturer. By the end of 1992, the year of the ban and the publicity that followed it, 10,000 cases had been filed, and by June 1995, about 248,000 women claimed to have illnesses related to implants. These illnesses include nebulous rheumatologic and immunologic disorders, fatigue, weakness, depression, and other symptoms that may be minimal or have multiple causes. No credible epidemiologic studies have shown a higher risk of these diseases in women with implants than in those without.

Angell provides the reader who may not be familiar with American tort law a general overview of contingency-fee plaintiffs' attorneys; a brief history of mass personal injury litigation in the United States; the extension of personal injury litigation to class actions; and a summary of the course of the breast implant class action suit. Angell notes that the subsequent extension of such suits to other silicone-containing medical devices poses a threat to all devices, whether containing silicone or not. For example, plaintiffs have made claims against the manufacturers of raw materials used in making silicone devices (p. 84). As a result, a large number of important products may become unavailable or prohibitively expensive. Angell concludes her criticism of current American tort law by asserting that it does not serve its stated goals of compensating the victim and deterring businesses from marketing dangerous products. Her analysis of this complicated topic, though abbreviated and somewhat simplified, nevertheless highlights important problems.

Next, in chapter 5, Angell turns her attention to the nature of scientific evidence. This chapter should be recommended reading for schoolchildren learning science and for laypersons without scientific backgrounds but who are interested in gaining a better understanding of what is and is not science. Angell believes that most nonscientists can understand much more than they think they can about medical research, and her chapter nicely exemplifies how to explain basic scientific principles to the nonscientist willing to learn. She then contrasts the scientific approach to what happened in the handling of breast implant issues.

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In chapter 6, Angell launches a carefully worded attack on the fate of science in the courtroom in general and the implant cases in particular. Her dry, factual recitation of the so-called credentials of three key plaintiff implant witnesses typifies her simple, clear, and convincing writing style, as she lets the facts speak for themselves and lead the reader to compelling conclusions (pp. 122–25). Her analysis of the traditional common-law Frye standard for admitting expert witness testimony and her explanation of the Daubert U.S. Supreme Court case and the federal standard are also very good lay overviews of existing evidence standards and related issues. Fortunately, these sections overshadow minor flaws in this chapter, such as Angell's mixing together of negligence, strict liability, and fraud elements in her attempt to explain what is theoretically required for a plaintiff to prove her case in court (p. 112). Surprisingly, she makes no reference in this section to work by Peter W. Huber, who has written extensively on expert testimony (see, e.g., *Galileo's Revenge.* New York: Basic Books, 1991).

Angell's final two themes pertain to profit motives and the media, respectively, in chapters 7 and 8. She notes that the unprincipled and unethical behavior of avaricious lawyers, doctors, expert witnesses, and the media helped disseminate and perpetuate the myth that implants are dangerous, despite scientific evidence to the contrary. She portrays the media's actions as part of a broader trend toward scaring a gullible and cynical public into believing it is drowning in a sea of toxins, a trend that has great entertainment value, especially if conspiracies are postulated (p. 158). She concludes that "people feel whipsawed by science, when they are really being whipsawed by the media" (p. 174).

The most amusing chapter comes at the end of the book, where Angell discusses the public's troubling trend away from science, reason, and logic and the growing fondness for "other ways of thinking" (chapter 9, pp. 178–91). She asserts that this popular trend away from science made the implant debacle possible and describes a variety of antiscience coalitions, each with different reasons for their antiscience views. These include humanists, who believe science has been oversold and has led to the emergence of a callous, technology-enthralled society; multiculturalists, who believe science glorifies the white male and bolsters the power of the governing classes; feminists who believe science is inherently "androcentric"; environmentalists; and proponents of alternative medicine and mysticism, who reject the principles of scientific evidence. Angell notes that "many Americans not only do not understand science, but they don't want to understand it and they don't think it's necessary that they do" (p. 188).

Angell is an especially credible author for a book that is highly critical of the handling of the implant scandal. As a physician, an executive editor of the prestigious *New England Journal of Medicine,* and a self-described femi-

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nist and liberal Democrat, Angell can hardly be dismissed as a reactionary element of the frequently caricatured white-male-dominated lunatic extreme right-wing or libertarian fringe. Her basic attitude is best illustrated by her discussion of the proper role for the FDA. Angell notes that Kessler had been a target of newly elected Republicans in Congress. She states that

> some of the new breed take the libertarian position that people should be free to choose their own drugs and devices; those that work will stay on the market, those that don't won't (perhaps by killing off their customers). According to this *swashbuckling* view, the FDA deprives people of choice and interferes with the wonders of a free market. There can't be many knowledgeable people who subscribe to *such silliness*, but still, there is a real issue here. (p. 64, my emphasis)

Angell's characterizations of libertarians and their views demonstrate that she is no advocate of drug and device deregulation. Nor is she an industry cheerleader. This preexisting perspective strengthens the force of her harsh criticisms of the FDA, the courts, and the media in their handling of the breast implant issues. As a liberal Democrat, she seems initially to have approached the topic expecting to find evidence of serious problems with the implants, but as a scientist she retained her objectivity and sought to evaluate existing evidence. With an Alice-in-Wonderland naïveté, she discovered that there was and is no credible evidence that implants are dangerous; moreover, the institutions she expected to be responsibly safeguarding the public's health were instead engaged in political grandstanding, unprincipled profiteering, and the perpetuation of ignorance.

Angell concludes by proposing reforms she believes would help prevent such incidents from recurring (pp. 202–9). Here, she clearly reveals her fundamental pro-regulation views and faith in the possibility of government beneficence. She favors forbidding contingency fees and eliminating jury trials in civil tort cases, but does not consider the constitutionality of eliminating civil jury trials or the additional problems further regulation of contractual attorneys' fees could create. Nor does she cite any studies to support her contention that judges would make better decisions than juries. She favors a requirement that judges appoint expert witnesses from a supposedly neutral pool of government-approved scientific experts, but offers no analysis of the potential problems of such a system.

Angell expresses disdain for the media's irresponsible handling of the debacle and the greed of lawyers and doctors who became rich off the continued crisis. Although she stops short of calling for media censorship, she implies that greater state regulation of doctors and lawyers would curb such avarice. She decries the public's unwillingness to make minimal efforts to

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evaluate scientific stories, but she offers no other suggestions on how to inspire the public's interest under the present system.

Angell concludes by reemphasizing that "only by relying on scientific evidence can we hope to curb the greed, fear, and self-indulgence that too often govern such disputes. That is the lesson of the breast implant story" (p. 209). An analysis of how to successfully achieve such a reliance may need to be the subject of a different book by a different author, but for now *Science on Trial* is worthwhile reading for anyone interested in tort law, FDA regulation, and the antiscience movement.

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Etceteras . . .

Bolingbroke, Nixon, and the Rest of Them

I'M NOT CERTAIN, but I'm willing to conjecture that Genghis Khan's executive office had no position for an Assistant to the Khan and Press Secretary; no Assistant to the Khan for Communications; no Assistant to the Khan for Public Liaison; no Deputy Assistant to the Khan and Director of Speechwriting; no Deputy Assistant to the Khan and Deputy Press Secretary to the Khan; no Deputy Assistant to the Khan and Director of Media Relations and Planning; no Deputy Assistant to the Khan and Deputy Director of Public Affairs; no Special Assistant to the Khan for Public Liaison; no Special Assistant to the Khan and Chief Speechwriter—all of which, if one merely substitutes the word *President* for the word *Khan,* President Ronald Reagan did have in his executive office. Genghis had no need to put a spin on his policy decisions. He expected his reputation to precede him, and if it didn't, so much the worse for the uninformed.

In the old days, everyone recognized a political leader as, in the words of Bertrand de Jouvenel, the "chief freebooter, leader of forays, director of the nation's strength" (*On Power: The Natural History of Its Growth,* translated by J. F. Huntington. Indianapolis: Liberty Fund, [1948] 1993, p. 96). For millennia, political leadership simply coincided with personal prowess in violence. Although leaders often strove to ease their exploitation of subjects by clothing themselves in religious or other forms of ostensible legitimacy, a clear-eyed subject appreciated that his only real choice was stark: obey or get hurt. Nobody wasted a moment supposing that the leader acted as an agent of the public or sought above all the public's well-being.

In recent centuries, as elected officials displaced absolute monarchs and dictators, people increasingly fell under the illusion that the government served them rather than itself; indeed, some even accepted the absurd claim that they *were* the government by virtue of their periodically casting a vote for one or another of the names placed on the ballot by the political ringmasters. In a flight of wishful thinking, subjects neglected to notice that the government—the collectivity of persons wielding power under color of

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official authority—even in a democracy "has its own life, its own interests, its own characteristics, its own ends" (Jouvenel, p. 103).

To reassure citizens that the voracious appetites of the government signified nothing more than an earnest desire to promote the public's well-being, governments, especially in the twentieth century, increasingly cultivated the arts of propaganda. Hence the battalions of special deputy assistant undersecretaries for bamboozlement listed earlier. As political leaders surrounded themselves with layer upon layer of mendacious flunkies, citizens came to possess less and less reliable information to assess the fidelity of their "public servants." Perennially immersed in a fog of disinformation, how could skeptical citizens ground their inchoate suspicion that the government actually conducted its affairs far differently than it claimed?

Of course, evidence sometimes does come to light confirming the suspicion, usually long after the deed is done. Lord Bolingbroke (1678–1751), an English politico of considerable clout in the early eighteenth century, penned one of the most forthright confessions in a letter to Sir William Windham:

> I am afraid that we came to court in the same dispositions that all parties have done; that the principal spring of our actions was to have the government of the State in our own hands; that our principal views were the conservation of this power, great employments to ourselves, and great opportunities of rewarding those who had helped to raise us, and of hurting those who stood in opposition to us. (quoted in Jouvenel, p. 126)

Somewhat earlier, the Marquis of Halifax (1633–95) made a similar observation: "Parties in a State generally, like freebooters, hang out false colours; the pretence is the public good; the real business is to catch prizes; and wherever they succeed, instead of improving their victory, they presently fall upon the baggage" (quoted in Jouvenel, p. 126, from *Maxims of State,* a compilation of Halifax's reflections).

The antiquity of these quotations does not warrant anyone's dismissing their applicability to modern conditions. For evidence of their enduring pertinence, consider that most unvarnished of all political records, the Nixon tapes. There, perhaps uniquely, we find the modern politician fully unmasked. In November 1996, after the Nixon estate gave up its fight to keep 201 hours of previously unreleased tapes secret, the National Archives made them public. Among them is a recording of an Oval Office conversation Nixon had with his two top aides, H. R. (Bob) Haldeman and John Ehrlichman, on 13 May 1971.

Echoing Bolingbroke, Nixon discussed the sort of person he wanted as commissioner of internal revenue:

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> I want to be sure that he is a ruthless son of a bitch, that he will do what he is told, that every income-tax return I want to see, I see. That he will go after our enemies and not go after our friends. It's as simple as that. (quoted in Donald M. Rothberg, "Nixon Felt Cabinet Had Abandoned Him, Tapes Show," *Seattle Times,* 19 November 1996)

Nixon seems to have believed that his predecessors had used the Internal Revenue Service similarly. On 27 May 1973 the president asked Ehrlichman if he had ascertained "who ordered...the audit of my income-tax returns in 1961" (quoted in Rothberg). Tricky Dick was not just hallucinating. As Elizabeth MacDonald has shown recently, "the Kennedys were far worse than Nixon in their manipulation of the IRS" ("The Kennedys and the IRS," *Wall Street Journal,* 28 January 1997).

The recently released tapes also reveal that in 1971 the president instructed Ehrlichman to sic the IRS on wealthy Jewish contributors to his Democratic rivals. On 8 September Nixon said: "John, we have the power. Are we using it now to investigate contributors to Hubert Humphrey, contributors to Muskie—the Jews, you know, that are stealing in every direction? Are we going after their tax returns?... I can only hope that we are, frankly, doing a little persecuting" (quoted in "Nixon Urged IRS Audits of Jews," *Seattle Times,* 8 December 1996). On 13 September Nixon told Haldeman: "Now here's the point, Bob, please get me the names of the Jews. You know, the big Jewish contributors to the Democrats" (quoted in "Nixon Urged"). The president wanted them investigated. The next day, talking to Haldeman and presidential aide Charles Colson, Nixon resumed: "What about the rich Jews? The IRS is full of Jews, Bob." Later he admonished, "Go after 'em like a son of a bitch!" (quoted in "Nixon Urged").

Although some may regard Richard Milhous Nixon as an egregious example, my own hunch is that he differed from most other successful political leaders mainly by extensively recording his private conversations and then failing to destroy the tapes that attest so plainly his motives, methods, and manners.

Of course, citizens in a democracy can always "throw the rascals out" at the next election. Here in the United States we have been flinging rascals hither and yon for more than two centuries. But what do we have to show for it?

Jouvenel, whose magnificent book *On Power* I have freely employed, had a clear vision of how the circulation of rascals, far from protecting the citizens, only shackles them more severely:

> Every change of regime and, to a lesser extent, every change of government is, as it were, a reproduction, on a more or less

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> reduced scale, of a barbarian invasion. The newcomers wander about the power house with feelings in which curiosity, pride, greed, all have a place. The credit which they then for the first time enjoy enables them to make full use of this formidable machinery, and even to add to it some further controls of their own. In time yet another faction will, by promising to make a better use of it, force its way in turn into the City of Command, which it will find already embellished by its forerunners. So that the hope, always renewed, of stripping from Power all trace of egoism results only in forging ever vaster means of compulsion for the next egoism. (Jouvenel, p. 131)

In the United States today, where two revolving factions of a one-party state farcically masquerade as authentic alternatives—the one specializing in crushing economic freedoms, the other in trampling noneconomic freedoms—we know all too well what Jouvenel meant.

ROBERT HIGGS

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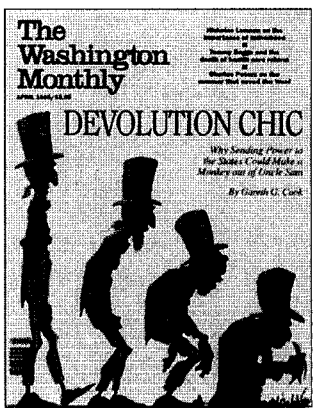

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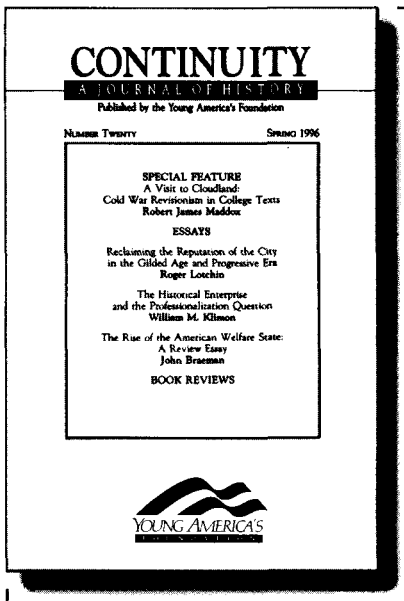

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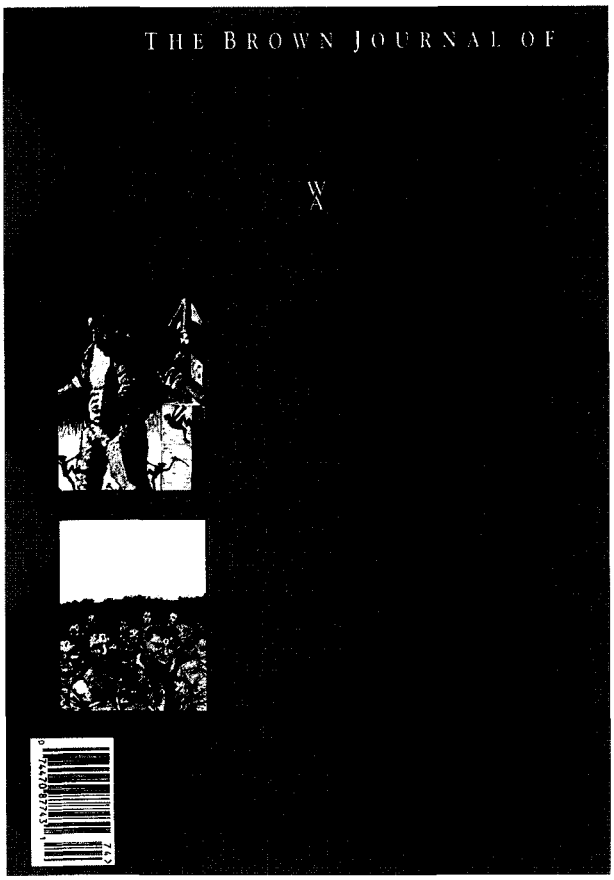

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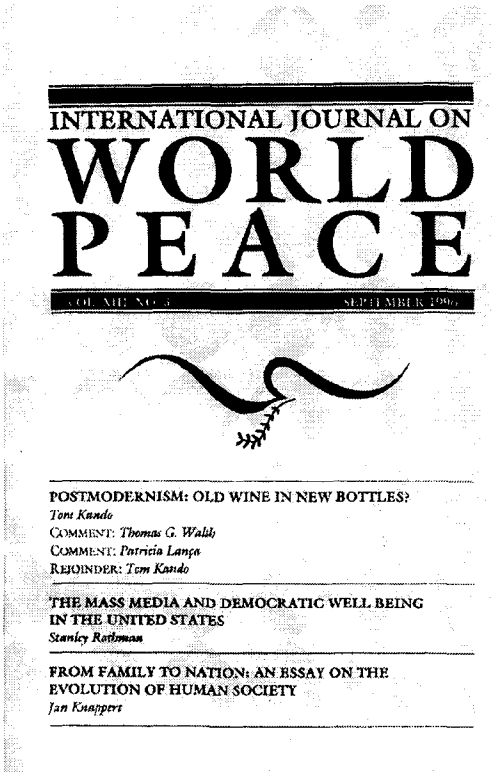
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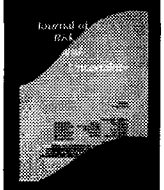

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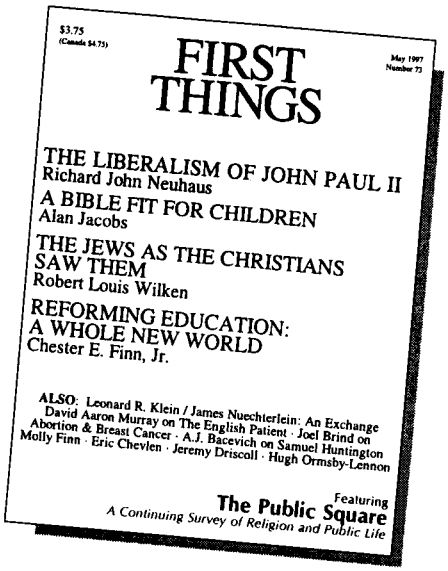
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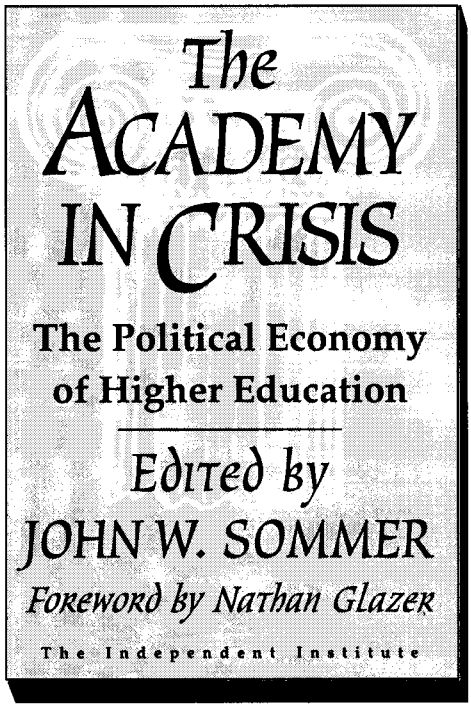

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